



Full Commission Meeting

Tuesday, January 11, 2005

10:00 a.m.

Senate Room A - General Assembly Building
Richmond, Virginia

APPEARANCES:

The Honorable Charles R. Hawkins, Chairman
The Honorable Terry G. Kilgore, Vice Chairman
Mr. Thomas W. Arthur
Mr. Stephen S. Banner
Mr. Clarence D. Bryant, III
The Honorable Kathy J. Byron
The Honorable Barnie K. Day
The Honorable Allen W. Dudley
The Honorable Matt Erskine
Mr. Fred M. Fields
Mr. L. Jackson Hite
The Honorable Clarke N. Hogan
The Honorable Isiah G. Hopkins
Mr. Jordon M. Jenkins, Jr.
The Honorable Joseph P. Johnson
Mr. Buddy Mayhew
Mr. H. Ronnie Montgomery
The Honorable Harrison A. Moody
Mr. Claude B. Owen, Jr.
The Honorable Edward Owens
The Honorable Phillip P. Puckett
The Honorable Frank M. Ruff
The Honorable Michael J. Schewel
The Honorable John Thomas Taylor
Mr. James C. Thompson
Mr. Gary D. Walker
The Honorable William Wampler, Jr.
The Honorable Thomas C. Wright, Jr.

COMMISSION STAFF:

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1 Carthan F. Currin, III, Executive Director
2 Ned Stephenson, Manager of Strategic Investments
3 Timothy Pfohl, Grants Program Administration Manager
4 Britt Nelson, Grants Program Administrator - Southside
5 Sara Griffith, Grants Program Administrator - Southwest
6 Stephanie Wass, Director of Finance
7

8 ATTORNEY GENERAL'S OFFICE:

9 Frank F. Ferguson, Deputy Attorney General - Counsel to the Commission
10 Anne Marie Cushmac, Senior Assistant Attorney General - Counsel to the Commission
11
12

13 SENATOR HAWKINS: I'll call this meeting to order, we've got a couple of hours,
14 there's another meeting scheduled for this room. I probably will be turning the gavel over to Delegate
15 Kilgore, my voice is leaving me, which is not a bad thing, I'm sure. Thank you all, and welcome to the
16 Commission meeting. We have a couple of housekeeping things we need to deal with. First of all, I'd
17 like to ask Staff to get with Mr. Walker. Charlotte County has lost four hundred jobs, and we need to
18 figure out something we can do, if there is anything we can do to concentrate some effort into that area
19 and to figure out what type of businesses and industry we can help bring in there and help grow there to
20 offset the losses of jobs. Four hundred jobs for Charlotte County is a lot of jobs for Charlotte.

21 The other thing I think we need to start concentrating on, it's my understanding that
22 Southwest Virginia, the telecommunications piece is about ready to go and almost the last mile and with
23 some effort on our part to be able to complete it. I'd like Staff to get with Southwest and figure out what
24 we can do to get that project finished so we can go ahead and get that one laid to rest and start working
25 on the Southside piece. I think it's important for us to go ahead and finish these projects rather than just
26 let them dangle, particularly if we can finish out the last mile.

27 Carthan, other than that, call the roll.

28 MR. CURRIN: Mr. Arthur?

29 MR. ARTHUR: Here.

30 MR. CURRIN: Mr. Banner?

31 MR. BANNER: (No response.)

32 MR. CURRIN: Secretary Bennett?

33 MR.: I'm here sitting in for John Bennett.

34 MR. CURRIN: Mr. Bryant?

35 MR. BRYANT: Here.

36 MR. CURRIN: Delegate Byron?

37 DELEGATE BYRON: (No response.)

38 MR. CURRIN: Commissioner Courter?

39 COMMISSIONER COURTER: (No response.)

40 MR. CURRIN: Mr. Day?

41 MR. DAY: Here.

42 MR. CURRIN: Delegate Dudley?

43 DELEGATE DUDLEY: Here.

44 MR. CURRIN: Mr. Fields?

1 MR. FIELDS: Here.
2 MR. CURRIN: Mr. Hite?
3 MR. HITE: Here.
4 MR. CURRIN: Delegate Hogan?
5 DELEGATE HOGAN: Here.
6 MR. CURRIN: Mr. Hopkins?
7 MR. HOPKINS: Here.
8 MR. CURRIN: Mr. Jenkins?
9 MR. JENKINS: Here.
10 MR. CURRIN: Delegate Johnson?
11 DELEGATE JOHNSON: Here.
12 MR. CURRIN: Mr. Mayhew?
13 MR. MAYHEW: Here.
14 MR. CURRIN: Mr. Montgomery?
15 MR. MONTGOMERY: Here.
16 MR. CURRIN: Mr. Moody?
17 MR. MOODY: Here.
18 MR. CURRIN: Mr. Owen?
19 MR. OWEN: Here.
20 MR. CURRIN: Mr. Owens?
21 MR. OWENS: Here.
22 MR. CURRIN: Senator Puckett?
23 SENATOR PUCKETT: (No response.)
24 MR. CURRIN: Senator Ruff?
25 SENATOR RUFF: Here.
26 MR. CURRIN: Secretary Schewel?
27 MR. ERSKINE: Matt Erskine here for Secretary Schewel.
28 MR. CURRIN: Mr. Stallard?
29 MR. STALLARD: (No response.)
30 MR. CURRIN: Mr. Taylor?
31 MR. TAYLOR: Here.
32 MR. CURRIN: Mr. Thompson?
33 MR. THOMPSON: Here.
34 MR. CURRIN: Mr. Walker?
35 MR. WALKER: Here.
36 MR. CURRIN: Senator Wampler?
37 SENATOR WAMPLER: (No response.)
38 MR. CURRIN: Mr. West?
39 MR. WEST: (No response.)
40 MR. CURRIN: Delegate Wright?
41 DELEGATE WRIGHT: Here.
42 MR. CURRIN: Mr. Vice Chairman?
43 DELEGATE KILGORE: Here.
44 MR. CURRIN: Mr. Chairman?

1 SENATOR HAWKINS: Here.

2 Next, I'd like to have a motion to approve the Minutes of the October meeting. It's been
3 moved and there is a second to approve the Minutes, all those in favor say aye? (Ayes.) Opposed? (No
4 response.)

5 Next on the agenda is the Report from the Southside Economic Development Committee, Mr.
6 Tom Arthur.

7
8 NOTE: At this point Mr. Stephen S. Banner, Delegate Kathy J. Byron,
9 Senator Philip Puckett and Senator William Wampler are in attendance.

10
11 MR. ARTHUR: Mr. Chairman and members of the Commission, on December
12 10th the Southside Economic Development Committee met in Danville at the Institute. We had a second
13 round of Economic Development proposals to work with. We had \$6,687,526.00 still available and
14 unused monies allocated to the counties. There were sixteen requests for the monies. In your packet
15 you will see a sheet that tells you what these requests were all about. Of the sixteen requests, two were
16 withdrawn, fourteen of the projects were approved unanimously by the Committee, all within each
17 county's allocations, totaling \$5,075,847.00 for the fourteen projects, leaving a carryover of
18 \$1,611,679.00 for the coming season. It is the recommendation of the Committee that you accept the
19 approved recommendations of the Committee as a block.

20 SENATOR HAWKINS: Is that a motion?

21 MR. ARTHUR: That's a motion, sir.

22 SENATOR HAWKINS: Is there a second to the motion? Any discussion? All in
23 favor say aye? (Ayes.) Opposed? (No response.) Thank you, sir.

24 Next is the Education Committee report, Senator Ruff. I'm sorry to rush us along, but we
25 have to be out of here by twelve o'clock, and we've got several fairly long opportunities to exchange
26 ideas, for lack of a better term. Senator Ruff.

27 SENATOR RUFF: Thank you, Mr. Chairman. The Education Committee met on
28 January 4th to deal with the applications. We agreed to 2.8 million to go to community colleges for
29 proposals that they made, and 400,000 per community college. That left a balance of 1.4 million for
30 competitive applications. Of that we proposed ten projects to go forward with. We tabled four projects,
31 and we left a balance of 275,000. I'd move the Full Commission accept those, and I can read them if
32 you want.

33 SENATOR HAWKINS: That's fine. Do you want to offer them as a block?

34 SENATOR RUFF: Yes.

35 SENATOR HAWKINS: There's a motion, is there a second?

36 MR. OWENS: Is there an obligation later --

37 SENATOR HAWKINS: Senator Ruff, did you hear the question?

38 SENATOR RUFF: Did they completely use the money, or have they done
39 something, what was the question?

40 MR. OWENS: Some of the counties in Southwest, was that money used from last
41 year's grant?

42 SENATOR RUFF: Last year's grant, I believe, went to six counties in Southwest
43 Virginia and seven counties in Southside. The proposal this year was to expand it to a greater portion of
44 the counties, whether they used all the money I'm not sure.

1 MR. PFOHL: Mr. Owens, our understanding is that
2 Tek.Xam needs to get out to the Southwest, get their work completed out there.

3 SENATOR HAWKINS: Does that answer your question? Any other discussion?

4 MR. FIELDS: Is that going to happen? Are they covering the Southwest ? Take
5 out the thing here if they're not going to cover it. Is it going to happen?

6 MR. PFOHL: The Executive Director of Tek.Xam said it's going to happen.

7 SENATOR HAWKINS: Mr. Owens.

8 MR. OWENS: Can you amend this grant so they can do that and come back with
9 some verification that they have, or are there more funding opportunities?

10 SENATOR HAWKINS: Do you understand the request for amendment?

11 SENATOR RUFF: Mr. Chairman, I'd ask that that one be pulled out of the block
12 before we vote on it and get the other nine out of the way.

13 SENATOR HAWKINS: Without any objection, that piece is pulled out of the
14 block, and we have the others as a block before us, and it's been moved. Is there a second? Any
15 discussion on the ones remaining in the block? All in favor say aye? (Ayes.) Opposed? (No response.)
16 That's passed, and we're back to the one out of the block. Senator Ruff.

17 SENATOR RUFF: Mr. Chairman, Tek.Xam was an application for \$194,600.00,
18 and the Committee recommended a \$194,000.00. Maybe the folks from Tek.Xam may want to come up
19 and address it, or maybe Tim, but sometimes money and events don't happen quite on the cycle we
20 would like it. I'm not sure if that was a timing or any other issue.

21 MR. PFOHL: Mr. Chairman, I think that Tek.Xam has accomplished what they
22 committed to do. They've been approved by the IRS as a 501C3 non-profit, and they've had good
23 successes in Southside. I think the next hurdle for them, as Mr. Owens has accurately pointed out, is to
24 get out in Southwest and demonstrate success in the five counties that they were committed to work in,
25 in last year's award.

26 SENATOR HAWKINS: And the problem has been?

27 MR. PFOHL: I would defer to Tek.Xam for why they have not been able to get the
28 work accomplished yet out there.

29 SENATOR HAWKINS: Yes, sir, would you mind identifying yourself?

30 MR. MILLER: Yes, I'm Stu Miller, Executive Director of Tek.Xam. What we
31 established to do, first of all, was to have ourselves become a 501C3. We were trying to work with the
32 Literary Foundation to establish a protocol there and we could get some joint funding. Also, we were
33 working on a financial kind of means test for folks as well. We worked with the Literary Foundation,
34 we worked with Southside Virginia Community College extensively trying to set a protocol in place
35 where we can actually have administratively --

36 SENATOR HAWKINS: -- When are you going to be in Southwest ?

37 MR. MILLER: Within the next two months. We've already talked with Mountain
38 Empire Community College, and we've already talked with folks out there to try to establish that same
39 protocol. Now we have a nice protocol in place, and we can go out there and offer that to them, as
40 opposed to trying to work it out. It took three or four months just to work out those kinks.

41 SENATOR HAWKINS: Does that address everyone's question? Mr. Fields?

42 MR. FIELDS: I have one more. You said you talked to the Literary Foundation,
43 are you getting funding from them?

44 MR. MILLER: Yes, we're getting some joint funding from them. John Forbes, he's

1 committed funding as well.

2 SENATOR HAWKINS: Does that answer your question?

3 MR. OWENS: Yes.

4 MR. FIELDS: Yes.

5 SENATOR HAWKINS: That's out of the block, and we'll vote on that. Is there a
6 motion and a second?

7 DELEGATE WRIGHT: I so move.

8 SENATOR HAWKINS: Is there a second? There's a second. Any discussion? All
9 in favor say aye? (Ayes.) Opposed, like sign? (No response.) That passes.

10 SENATOR RUFF: Mr. Chairman, we dealt with three other issues over the last
11 three years in the Scholarship Program for the four-year colleges. We have allotted that money in the
12 summer, which has made it difficult to process those applications and take the fear out of the families as
13 to how they're going to finance the education. We would ask to approve the 3.8, no less than 3.8 million
14 that we put in scholarships for the last three years so those applications can go ahead and start coming
15 in, and money would still be paid out at the beginning of September. It would make the paperwork flow
16 much better, and I would make that motion.

17 SENATOR HAWKINS: That was one of the recommendations of the Executive
18 Committee yesterday, to accept that?

19 SENATOR RUFF: That's correct.

20 SENATOR HAWKINS: That is in the way of a motion, is there a second? It's been
21 moved and seconded that that part would be agreed to. All in favor say aye? (Ayes.) Opposed? (No
22 response.) The motion carries.

23 SENATOR RUFF: Mr. Chairman, next is that the Committee believes that we
24 ought to engage an audit firm to perform an audit of the various scholarship programs funded by the
25 Commission. We believe that as much money as we put into that we need to make sure that we do not
26 make mistakes that need to be straightened out. So I would move that an audit be authorized by the
27 Commission.

28 SENATOR HAWKINS: Does everyone understand the motion? It's been moved,
29 and there's a second. Any discussion? All in favor say aye? (Ayes.) Opposed? (No response.) Thank
30 you, sir.

31 SENATOR RUFF: The last motion is to change the scholarship proposal
32 somewhat. I believe each one of you has it in the packet, but it reduces the amount in Southside Virginia
33 from \$4,000.00 to a maximum of \$3,000.00, \$1,500.00 if they are part-time students, and instead of just
34 teachers and a selected group. If they make a commitment to come back to Southside Virginia in any
35 capacity to work, then it would become a forgivable loan. If they do not, they would owe the money,
36 and it would change from a four percent interest to a prime plus three percent. We believe that will keep
37 anyone who is not serious about coming back to Virginia. Southwest, they leave their full-time students
38 at 1500 and change the undergraduate, part-time 1500 maximum to a 1000 maximum, and that covers
39 most of it. There is a spreadsheet in front of you that changes the criteria slightly and it would be judged
40 on GPA rather than first-come/first served. I would move those changes be accepted.

41 SENATOR HAWKINS: It's been moved and seconded, any discussion?

42 DELEGATE DUDLEY: Mr. Chairman, Frank, for the interest rate, would that
43 affect people that already receive scholarship assistance, or for new people?

44 SENATOR RUFF: It would begin this year, any money that is already out there, I

1 think we're obligated as is, but any new loans that the third year or fourth year or second year would be
2 under the new scenario. What's already happened has happened.

3 SENATOR HAWKINS: Delegate Dudley, does that answer your question? It's
4 been moved and seconded, any more discussion? All those in favor say aye? (Ayes.) Opposed? (No
5 response.) The motion carries. Thank you, sir. That completes the Education Committee's report.

6 Next we have an update from Mr. Lewis. Welcome.

7 MR. LEWIS: Mr. Chairman and members of the Commission, a very brief update
8 on tobacco indemnification. We have just completed the last round of payments to burley quota owners.
9 As you may recall, we transferred the 1999 database, and we've caught up those folks in Southwest
10 Virginia. Those members in Southwest Virginia, we very much appreciate your assistance and patience
11 in completing this last round of burley quota payments, and we are now preparing for the 2005 cycle.
12 We look forward to guidance from the Staff and the Commission as to what will be our payment cycle in
13 light of what is going on with Phase 2, their payment structure. Everything is moving forward, and we
14 will begin the 2005 payment cycle in the next two months.

15 SENATOR HAWKINS: All right, thank you, sir. Any questions? Thank you,
16 appreciate that.

17 Next we have the Executive Director's report. Before we get into that, Carthan, I just want to
18 share, last year, if you remember, we had legislation introduced dealing with this subject. Senator
19 Puckett and Delegate Kilgore carried that particular legislation. At that point it was determined that
20 nothing would move forward until there was some sort of agreement, which was not reached. This year
21 we're back with a very complex, convoluted subject, trying to understand how we would handle it. It is
22 my recommendation that the Commission does not as a whole take a position on any particular piece of
23 legislation, but also it would be up to us to make sure that we understand it fully enough to be able to
24 explain it to the rest of the members of the General Assembly when it comes to a decision that we will
25 be making on how these things are to be put into place. This is probably one of the key pieces of all the
26 discussions that we will be having for the next several weeks. Having said that, Carthan.

27 MR. CURRIN: Good morning, Mr. Chairman and members of the Commission,
28 Happy New Year. First, Mr. Chairman, I bring to your attention, and of course, all of us know about the
29 federal buyout legislation which passed Congress and was signed by the President last year. We're not
30 quite sure at this point exactly how those monies are going to flow and who is going to work the
31 mechanics of that, but those issues are being worked on presently, and we'll have more information, and
32 I'll be conveying that to the Commission.

33 On the Phase 2 payments, December 22nd a North Carolina judge ruled that the cigarette
34 manufacturers don't have to make their final Phase 2 payment because of the passage of the federal
35 tobacco buy-out legislation. This payment would have been made in December of 2004. The ruling is
36 being appealed, but it will take some time, so at this point I'm not sure what will occur with regard to
37 those Phase 2 payments.

38 At our last meeting I indicated that the Commission's remaining obligation for losses through
39 2002 totaled 128.8 million dollars. This assumed that in 2004 the Phase 2 payments would be made as
40 forecast. However, if the ruling stands and the last Phase 2 payments are not made, the Commission's
41 obligations could potentially increase by 28.3 million dollars. Currently we have 20 million budgeted
42 for indemnification for fiscal year '05, which can be subtracted from this total. Legislation will be
43 shared for the potential thereof. Later, Mr. Chairman, I'll be bringing before you two groups that will be
44 representing some comments on this subject, and differing comments.

1 SENATOR HAWKINS: Do you plan to orchestrate that from the podium?

2 MR. CURRIN: Yes, sir, I plan to, and I hope to.

3 SENATOR HAWKINS: Put some ground rules down before we get into this
4 discussion. We're on a real tight time frame.

5 MR. CURRIN: Yes, sir, they are aware of that, and I've indicated to both sides that
6 their representatives have twelve minutes apiece to present.

7 SENATOR HAWKINS: Twelve minutes apiece?

8 MR. CURRIN: Yes, unless, Mr. Chairman, you'd like to change that.

9 SENATOR HAWKINS: No, that's fine. Delegate Kilgore has a question.

10 DELEGATE KILGORE: This is about the last slide where you were talking about
11 our obligation may be increased 28 million dollars on the Phase 2 if the court rules or if that ruling is
12 upheld, but can you tell us how or why?

13 MR. CURRIN: I'm going to direct it to the Director of Finance to respond to that.

14 MS. WASS: Our assumption of 128.8 million was assuming that Phase 2, the last
15 Phase 2 payment would occur. If it does not occur, then we need to cover that obligation.

16 MR. CURRIN: That's a matter of policy the Commission decided way back in
17 2000.

18 SENATOR HAWKINS: Thank you, sir.

19 MR. CURRIN: If there was any interruption of the Phase 2 payments.

20 SENATOR HAWKINS: Now, the presentation that we're fixing to deal with?

21 MR. CURRIN: Not quite, we're going to finish up here, introduce some other
22 folks on a separate issue, and then at the end of that I will bring the folks representing the cigarette
23 manufacturers. We have a couple of action items I want to bring to your attention.

24 SENATOR HAWKINS: Fine.

25 MR. CURRIN: Members of the Commission, the Executive Committee met
26 yesterday and addressed a number of issues which come before you today for action. First, the
27 Committee reviewed and voted to recommend for approval the revised guidelines for the Tobacco
28 Region Opportunity Fund. The proposed guidelines were sent to you before Christmas for review. Does
29 anyone have any questions concerning those guidelines and changes that the Staff recommended and the
30 Executive Committee voted on? The Executive Committee voted on those recommendations yesterday
31 and unanimously supported the Staff's recommendations. Let me go over a couple of bullet points for
32 you.

33 Our current guidelines said we had to have twenty-five minimum jobs, and that has now been
34 done away with, at least at this point, by the Executive Committee. We had a couple of instances last
35 year in Smyth County and Charlotte County and a couple of other places where we had opportunities
36 that came before us that didn't quite meet that twenty-five job threshold, and we felt that after going
37 through those experiences that we needed to be maybe a little bit more flexible. We had a situation
38 where we had nineteen jobs or twenty jobs and that kind of situation. So there is now a minimum of a
39 \$50,000.00 grant threshold that could be achieved by grant to the TROF process. Now the Executive
40 Committee has recommended that you all boosting up from two per fiscal year, two TROF grants to
41 three, and that the approve process be changed from requiring three of the four votes that consist of the
42 TROF Committee.

43 SENATOR HAWKINS: Any discussion on the recommendations from the
44 changes? Carthan, do you need a motion on that?

1 MR. CURRIN: I would, Mr. Chairman.

2 SENATOR HAWKINS: Is there a motion?

3 SENATOR RUFF: Mr. Chairman, I move we accept the Executive Committee's
4 recommendation.

5 SENATOR HAWKINS: Is there a second, there is a second. Any discussion?

6 MR. TAYLOR: Mr. Chairman, will that still get the emergency grant, if we have
7 two grants --

8 MR. CURRIN: Mr. Taylor, if I understand your question, you're boosting up from
9 two to three now, there'll be three per fiscal year that a locality, city or county has an opportunity to
10 come to the TROF Committee so they can get three per year instead of two.

11 MR. TAYLOR: Will there be a possibility of --

12 SENATOR HAWKINS: I would think, let me make a statement on that. Our
13 whole purpose is trying to create an economy, and to do that we need the ability to be able to act very
14 quickly when an opportunity comes about. We cannot afford to lose an opportunity based on some sort
15 of premature regulations put in place. We have been able to avoid a great deal of that, but we may have
16 created some problems for ourselves by limiting some ability. This gives us this ability. In my mind, if
17 a situation avails itself, like in Charlotte County, Mecklenburg or wherever, or Southside Virginia or
18 Southwest Virginia that there's an opportunity to create the dynamics that we need for new economies,
19 then we need to act. If it means getting a phone call and getting the Commission on the phone, we just
20 need to act. I don't think this in any way will impede us from doing something out of the ordinary if
21 something takes place. This gives us a little more flexibility when it comes to adding one more piece to
22 the overall local economic puzzle.

23 MR. CURRIN: Thank you, Mr. Chairman. The section I had with regard to
24 education, you've already dealt with that issue, so I'll continue on. Speaking of the TROF, we have a
25 situation that, until you all vote on this, we have a TROF request from Smyth County, and their third,
26 and has to come to the Full Commission. You see before you the request is for \$70,000.00, a net of
27 thirty-seven jobs and a total capital investment of 1.3 million dollars. For this to be approved the
28 Commission has to act on it.

29 DELEGATE KILGORE: Carthan, this may be a question for Ned. It otherwise
30 meets the guidelines?

31 MR. CURRIN: Yes, it does.

32 MR. STEPHENSON: As long as it is approved.

33 SENATOR HAWKINS: Is there a motion?

34 MR. JOHNSON: Mr. Chairman, I so move.

35 SENATOR HAWKINS: It's been moved and seconded, discussion? All in favor
36 say aye? (Ayes.) Opposed? (No response.) Motion is carried.

37 MR. CURRIN: Thank you, Mr. Chairman. As we have done in the past, we will be
38 conducting economic development workshops.

39 DELEGATE DUDLEY: Mr. Chairman, did we actually vote on the change to the
40 TROF guidelines?

41 SENATOR HAWKINS: Is there a motion to vote on the changes to the guidelines?
42 It is so moved, is there a second? There is a second. Any discussion? All those in favor of the changes
43 say aye? (Ayes.) Opposed? (No response.) Motion carries. Thank you, Delegate Dudley.

44 MR. CURRIN: Mr. Chairman, I believe Mr. Stephenson would like to bring before

1 you another request from Smyth County.

2 MR. STEPHENSON: Gentlemen, quickly, since all of this went to press a fourth
3 TROF transaction in Smyth County came to light, and it meets all of the guidelines. The TROF panel
4 has seen it and approved it. It is for a yet unnamed project, because the announcement has not been
5 made. The request is for \$100,000.00, and your Staff and your TROF panel brings this recommendation
6 today for approval.

7 SENATOR HAWKINS: It meets all criteria?

8 MR. STEPHENSON: It does.

9 MR. JOHNSON: I move we grant this.

10 SENATOR HAWKINS: It's been moved and seconded. Any discussion?

11 MR. DAY: How many jobs does this bring?

12 MR. STEPHENSON: Forty-nine jobs, Mr. Day.

13 SENATOR HAWKINS: Mr. Day, does that answer your question?

14 MR. DAY: Yes.

15 SENATOR HAWKINS: It's been moved and seconded that we agree to a
16 \$100,000.00 request for Smyth County, which is their fourth, and which is good, by the way, and that
17 means they are getting things going. It's been moved and seconded, any discussion? All in favor say
18 aye? (Ayes.) Opposed? (No response.) Motion carries.

19 MR. CURRIN: Thank you, Mr. Chairman. As we have in the past, we will be
20 conducting an Economic Development grant workshop in Southside and one in Southwest to assist
21 potential applicants in understanding the application process that we have. The Southwest workshop is
22 scheduled for January the 20th at 2:00 at the Southwest Virginia Higher Education Center. The
23 Southside workshop is in the process of being scheduled. We'll let you know when that schedule is
24 final.

25 SENATOR HAWKINS: We need to make sure that there is an understanding, the
26 more regional projects we can put into place and bring together to our localities and we're not wasting
27 capital and not trying to tread on each other's turf but working together for economic development, we're
28 better off. Also, I reviewed some of the local requests we had in the last month or so. Things like
29 upgrading air-conditioning systems, commercial retail parks, that doesn't do much for economic
30 development. We need to have an understanding that this Commission has to be in place to be able to
31 bring forth those new ideas to create new dynamics, and to do that the localities need to come up with
32 creative ideas and thinking outside of the norm. Upgrading air-conditioning systems and retail parks,
33 my history of retailing, I can assure you if you have enough capital in place and enough spendable
34 income, retailing will follow you, and you don't have to worry about that, because it will be there.

35 Any other questions?

36 MR. CURRIN: Thank you, Mr. Chairman, that's a very good segue into my next
37 slide. From the last Commission meeting when we met in Clarksville we also had a strategic retreat,
38 and from that retreat some of the consensus items are before you. I will be working with Delegate
39 Byron to schedule a meeting of her Long-Range Planning Committee to review and explore updates as
40 pertains to our current Long-Range Plan. We will, of course, be addressing these issues and others that
41 come before her committee when the process begins.

42 Mr. Chairman, I'm getting ready to introduce Chris Chmura of Chmura Economic Analytics.
43 She recently completed a study for Southwest Virginia, helping them to identify the industries that they
44 should be targeting. Before I introduce Chris you may recall last year the Commission allocated funds

1 to Southwest and Southside for marketing initiatives. This is a representation of how some of those
2 funds have been used. I am very pleased to have this information before you today. I think it is exactly
3 what we have been trying to achieve with these efforts. At this point I would ask Chris Chmura to come
4 up and make her presentation on the findings with regard to this study for Southwest Virginia. After
5 which, Mr. Chairman, I'd like to ask Ron Flanary, the Executive Director of the LENOWISCO Planning
6 District to come up and speak to this issue briefly.

7 MS. CHMURA: Thank you. Carthan said what I have to do is the findings or the
8 end points of a one-year study that was performed for the Southwest Virginia Alliance. Basically, in
9 terms of the scope and approach, they asked us to come up with a scientific process to help increase
10 their efficiency in economic development. In order to do that, or the outcome of that for us, was to be a
11 statistical model that would identify the probability that that particular firm would actually relocate to
12 their region. We did this, and as I said before, the Southwest Virginia Alliance, that's made up of PDC 1,
13 PDC 2, PDC 3 and Floyd County. They also asked that this be an updatable process that we could
14 update it over time.

15 In terms of the entire process, it took about a year, and we had monthly meetings with the
16 Southwest Virginia Alliance individuals, and that was mainly Charles Yeatts, Andy Hall and Ron
17 Flanary. We began with a base line to look at the economy, and from there we created clusters of
18 industries, and from there we worked on an econometric model to come up with a probability that a firm
19 would expand. We validated the model, and then we created a method to track the performance over
20 time. Last week we presented our final report to the Committee, as well as to the economic
21 development officials within the Southwest Virginia Alliance region, and now it's time for the Southwest
22 Virginia Alliance to implement and go after the firms that we provided to them.

23 In terms of a very broad overview of our findings, the baseline analysis in terms of a swath
24 indicated that the strengths are in the mining industry, where the pay is about \$50,000.00 a year and in
25 manufacturing, which pays about \$1,000.00 more than the \$26,000.00 average salary in that region. The
26 weakness is in the same industries in that mining and manufacturing are in decline, so jobs are being
27 lost. There are opportunities, because as you look at the occupations within those industries, those
28 occupations have skills that can be used in other industries. It's just a matter of identifying those
29 industries and bringing them into the region.

30 Another big opportunity, and this is something that this Commission could take credit for and
31 pat themselves on the back for, and that is the fiber optic network. That region really has a strong
32 opportunity to bring in some other high-paying jobs. A threat would be that the individuals who lost
33 their jobs, in losing their jobs will leave before we're able to bring in other industries.

34 The second piece of the analysis was to look at the clusters or the industries that grew
35 together because of supplier/buyer relationships. When we did that, and here you see the map, and light
36 yellow is the study region, and the green shaded areas around it are also counties that were close enough
37 that we counted them when we were doing the cluster analysis. If you live in Scott or Washington
38 County you may travel down to Sullivan County and work at Eastman. We took into account the
39 chemical clusters, or the other clusters that were in the contiguous counties.

40 In doing that we came up with eighteen clusters, and we had to narrow that to seven clusters.
41 In order to do that we looked at the wealth clusters that are brought to the region, the employment
42 growth that the clusters would bring to the region, and the innovations, from a long-term perspective
43 would it be an innovative industry, and the competitiveness of the particular clusters. Just to show you a
44 couple of the charts we had as a result of that analysis, here you see the locations of the eighteen

1 clusters. The location quotient, if it is one or greater, indicates that the cluster is competitive and you
2 have an advantage relative to other regions. In red, those are very competitive clusters of the Southwest
3 Virginia region. Mining, farming, wood and textiles all in one cluster.

4 When you look at employment growth you can see the three clusters that are the most
5 competitive and important in the Southwest region right now are all expected for the most part, three of
6 the four are expected to see decline in terms of employment, with textiles showing the greatest loss.
7 That's a 58 percent loss over the next ten years in terms of jobs.

8 From there we had to identify again which of these clusters should we target. We talked to
9 the officials in the Southwest Virginia area and decided we would target clusters based on the
10 employment growth that they had, the annual wages that they had and, put a small weight on their
11 current competitiveness that they have in the region. We created a gaming software to walk those
12 officials through this process, and here are the final clusters that we came up with: chemicals,
13 transportation equipment, wood, pharmaceutical, general manufacturing, electronics. In the early
14 analysis, data processing came up as a cluster, it was within business services. We took it out and put it
15 back in because of the fiber optic network in the area. We have eighty industries within our clusters, and
16 we have to figure out how we narrow it down to those industries that are most likely to come to
17 Southwest Virginia. There we did the econometric model. To go back to 101 and take a look at the left-
18 hand side, we're trying to figure out what is the probability to expand. We used factors such as the
19 economy, the industry, specific factors, firm- specific factors, and the location of the area. By your
20 smiles I can tell you all remember those particular ones.

21 We looked at three thousand firms in this model over four years, which gave us twelve
22 thousand observations. This is a list or example of the industries with the greatest probability of going
23 to the Southwest Virginia region. We provided the same list for each one of the counties and cities in the
24 area. We also provided firm-specific data. In any case we had to validate that model to make sure that
25 the firm-specific data and the industry data were as the model was saying. To do that we designed a
26 survey and spent a couple of months surveying firms and got about a ninety-percent response rate,
27 which is pretty good for that survey.

28 That survey indicated that our model predicted correctly when a firm was going to expand in
29 the next six to nine months, or at least expected to expand, with a small five-percent error at the industry
30 level. We did that initial analysis, and at the firm level we found two with all these results that the
31 model predicted well.

32 Then, finally, using a more traditional and more formal test, we took the genie coefficient,
33 which has nothing to do with the lady in the bottle, and it gave us seventy percent. Seventy percent tells
34 us that we have an effective model.

35 Finally, then, to supplement our analysis, we took an industry expert approach, and this
36 occurred parallel with the whole project for that period of one year and provides more of a human
37 dimension that you would typically think of in traditional economic development. It was connected to
38 that model because it relied on the clusters that we identified. In terms of identifying industry drivers
39 we took a look at the coal industry, which is in decline however, on the environmental side there are
40 potential ancillary industries that could provide jobs in the Southwest region. We identified a
41 Pennsylvania firm, and that information has been passed on to the Southwest Virginia officials.

42 From a chemical perspective we spoke with some other chemical firms and talked to them
43 about the possibility of expanding a large chemical firm, and most of those are looking to decrease their
44 cost structures, and as a result any expansion in Southwest Virginia would be more likely ancillary firms

1 related to corn for biofuel.

2 In looking at occupations, we found that there was a surplus of welders because of declines in
3 mining and identified other areas in the state, transportation equipment firms who needed welders. We
4 passed on information to Southwest Virginia officials to pursue that route.

5 We also looked at supply chain gaps, and when you look at a supply chain in the glass
6 industry you would expect that they're selling it to motor vehicles on that slide. But we identified in
7 green that there were no motor vehicle operators in terms of glass and then discussed further with some
8 firms the option of moving to Southwest Virginia, and that information was passed on.

9 We provided the final report last week, and the next step is now for the Southwest Virginia
10 Alliance to follow up with this list of five hundred potential candidates for relocation that were
11 identified based on the model that we had, then for them to let us know the feedback that they get, was it
12 a yes, or was it a no, or was there any interest, so that we can continue to improve the model. From our
13 perspective we've completed this project. Potential future steps could be to rerun the model if there is a
14 particular area in the country that Southwest Virginia wants to target in terms of trying to get some firms
15 to relocate to this region.

16 In conclusion, we created a systematic and scientific process to target firms. The model was
17 developed and tested, and the target industries and firms were identified, and now we're very anxious to
18 see Southwest Virginia follow up, and the kind of responses they get from that list.

19 Thank you.

20 SENATOR HAWKINS: You alluded to the telecommunication piece that we're
21 working on. Without the initiative on the telecommunication side, in your professional opinion, where
22 would we be economically?

23 MS. CHMURA: The fiber optics, that is attracting some firms to your region that
24 would not otherwise have considered it. Potentially, that is opening up a whole new cluster for the
25 region that will bring in higher- paying jobs.

26 SENATOR HAWKINS: But of all the initiatives that we possibly could have
27 worked on, that sort of connectivity is probably one of the things that we need to concentrate on,
28 wouldn't you say?

29 MS. CHMURA: I don't know all of the initiatives, but it is a very important one.

30 SENATOR HAWKINS: Any other questions?

31 MR. CURRIN: Mr. Chairman, I would like to ask Ron Flanary, representing the
32 Southwest Alliance, to give a few comments in regard to this study and some comments to the
33 Commission as far as next steps.

34 SENATOR HAWKINS: Welcome, sir.

35 MR. FLANARY: Thank you, Mr. Chairman, and thank you, Carthan. I'll be very
36 brief. If you have any technical questions I'll refer you to Dr. Chmura. Obviously, we're pleased with
37 this work, and it's an analytical approach to marketing. It represents a great change from the days when
38 I started in this field in 1975. Back then marketing was more networking, call trips and outreach, and
39 that's still a large part of it. We have to be far more intelligent with the way that we target firms and how
40 we locate these things and flush them out, particularly as we move into this broadband initiative. We're
41 pleased with this approach, and we've got a lot of work to do, we've got five hundred firms that we need
42 to follow up with, and that's a process that is going on right now.

43 As far as next steps, we'd like to come back, if possible, to the Special Projects Committee, at
44 some point in the near future, with a more modest financial request, because obviously the maintenance

1 and upkeep of this process is going to be less costly in developing the process from scratch. I wanted
2 you to know we're very happy with this, and we feel like we've got some marketing targets now that
3 have been more carefully thought through, and maybe this will translate into some investment and some
4 job creation.

5 I'll be glad to answer any questions of a general nature.

6 MR. DAY: Mr. Chairman, can you give us one or two examples if this approach is
7 going to work?

8 MR. FLANARY: I'm not sure that it has been done before. This is a totally new
9 approach to take an analytical approach into marketing. I'll ask Chris to address that.

10 MS. CHMURA: We have not found another area that has done this, so when
11 Charles Yeatts came to us a year or so ago to look at it from a scientific approach we were basically
12 building a whole new, an entirely new model.

13 SENATOR HAWKINS: One thing, if I remember, a lot of things that we're doing,
14 we're doing a lot of new initiatives, and there's no model to work from.

15 MR. DAY: When you interview some of these industries do you find that what the
16 industries are looking for, do you find what they're looking for specifically like one, two or three,
17 employment and the tax rate and so forth?

18 MS. CHMURA: Let me ask Leslie Peterson, my business partner, who did a lot of
19 this. She can answer that.

20 MS. PETERSON: Specifically, I was speaking to industry experts that I knew from
21 my Eastman days, and we were trying to identify drivers that would cause businesses and firms to
22 implement change. Those could be environmental drivers, policy drivers, cost drivers. From that we
23 asked specifically, would you consider relocating or expanding to Southwest Virginia, then they would
24 want to know why, and what's in it for me. The fiber optics is very important, we got a lot of firms that
25 said they were concerned about the workforce there. When you tell them that Eastman Chemicals is
26 right across the border and there's pharmaceuticals right across the border, that changes everything. Did
27 I answer your question?

28 MR. DAY: Yes.

29 MR. FLANARY: I would just amplify that and say that we have a lot at the sales
30 end to do, but at least we want to make sure we have an opportunity, and now we have an opportunity to
31 appear to have a dialogue with these firms. I think the questions of size, workforce and capabilities and
32 taxes, all these things that follow to help close the deal are still there, but now we have an opportunity.

33 SENATOR HAWKINS: I think your work is very impressive, thank you.

34 MR. FLANARY: We appreciate your support.

35 MR. CURRIN: Just one follow-up to this, Mr. Chairman. The Southwest
36 undertakes this opportunity and would like to consider working with Mr. Arthur and the Southside
37 Economic Development Committee in looking into opportunities for Southside with this kind of
38 concept.

39 SENATOR HAWKINS: We have an hour and fifteen minutes, would you like to
40 switch and take the Economic Development Partnership first and get that out of the way so we'll be able
41 to concentrate on the last part, or not?

42 MR. CURRIN: I'll do that, Mr. Chairman.

43 SENATOR HAWKINS: Let's do that so we'll have some kind of understanding of
44 the time frame we're working with.

1 MR. CURRIN: Mr. Kilduff.

2 SENATOR HAWKINS: Mark, I'm sorry to put you on the spot. Do you mind?

3 MR. CURRIN: Mr. Chairman, Mr. Majors, who is on the Partnership Board, would
4 like to make some introductory comments.

5 SENATOR HAWKINS: Mr. Majors, welcome, sir.

6 MR. MAJORS: Thank you, Mr. Chairman, members of the Commission, I'm
7 Charlie Majors from Danville, and about three years ago I had the honor of serving as co-chairman with
8 Tom Morris with the Long-Range Planning Committee, bringing a long-range plan to this Commission.
9 For the past year I had an opportunity to serve as a member of the Board of the Virginia Economic
10 Development Partnership, representing the Fifth Congressional District. I am here today representing
11 the Board. Mark Kilduff, our Executive Director, will be making a presentation. But on behalf of the
12 Board, I would like to say to you that we recognize the importance of the Partnership and the
13 Commission working together for the revitalization of the tobacco region. We would also like to
14 emphasize our interest in positive and open dialogue with the Commission in achieving that. Thirdly,
15 we would like to emphasize for openness to be innovative in our approach to economic development so
16 we can have an effective approach to economic development throughout the Commonwealth, but
17 particularly in the tobacco region.

18 With that introduction I'll turn it over to Mark Kilduff, who will make a presentation on behalf
19 of the Partnership. Thank you.

20 SENATOR HAWKINS: Welcome, and I think this is very important to all of us as
21 we figure out the very best way we can partner with the activities going on in the state agencies and
22 concentrate on these areas that we're trying to make sure that we have as positive an impact as possible.
23 I think what most of us would like to know is what is the Partnership doing to focus the needs of
24 Southside and Southwest Virginia when it comes to economic development and if, in fact, you can see
25 opportunities where the Partnership can help us and we can help you develop these things we so
26 desperately need to develop.

27 MR. KILDUFF: Mr. Chairman, I'll give it a shot, and it's a great pleasure to be
28 here, and I would like to echo what Charlie just said. I want to personally thank you for the cooperation
29 and support that the economic development region has received from the Commission, it's been a great
30 help, and we do view you as a significant and terribly important partner.

31 I'd like to take a very few seconds and talk about what we're calling the changing face of
32 economic development. Things have changed very dramatically in the way projects come to us, the way
33 that we find projects and the way we work projects. First I think it's obvious to every member of this
34 Commission for sure is the very significant change from the type of projects that are before us. If you
35 went back ten years or twenty years, seventy or seventy-five or eighty percent of the projects we were
36 involved with were in manufacturing and maybe twenty percent in non-manufacturing. And today those
37 numbers are reversed. If you go the last three or four years in Virginia, whether it's our announcements
38 or the projects we're working on, about seventy to seventy-five percent are non-manufacturing. Only
39 twenty to twenty-five percent are manufacturing. It's one big change, non-manufacturers have different
40 needs, not only physical infrastructure needs, site needs, they have particularly different labor needs.

41 The second point I want to make is the impact of the Internet. In the past I think the process
42 would have been for us to find projects and then learn what that company or that consultant was looking
43 for, what size site, how many people, do you have any environmental issues, must you have natural gas,
44 and the list goes on the hundreds of factors, and that is changing. The prospects and the consultants that

1 we're dealing with now have gone to the Internet, and they've gone to our website, and they've gone to
2 the local websites, they have gone to regional websites, they have gone to federal government statistics,
3 they've gone to state government statistics, all of which they have been able to gather off the Internet.
4 Instead of coming to us and telling us about a project and asking for advice, and it's not just us, because
5 the same is true for regional local groups, they are saying to us, I want to see this particular site, I want
6 to visit that community that holds an interest, this is a particularly good building I would like to follow
7 up on. The use of the Internet is changing the way economic development is done, and manufacturing.

8 The same with regard to consultants. If you went back just ten years ago, the use of a
9 consultant for a site-location process was a relative rarity. Today twenty to twenty-five percent of our
10 projects are coming from consultants. The fact is those are better projects and in terms of investment
11 four times larger than the average, and in terms of employment they are three times larger than the
12 average, and they move faster. That goes to the next point on the compressed time frame.

13 The amount of time that we, or local economic developers and regional developers have to
14 touch a prospect, the time that we have to influence that decision, is shrinking dramatically. As recently
15 as seven to ten years ago I would think it would not be unusual for a prospect to be working for eighteen
16 to twenty-four months; today it's six months. In 2004 the average time we had to touch a project was
17 179 days, and if you went to some of those we were down to 140.

18 The final point I want to make, and it's a simple summary. Economic Development has
19 become a process of elimination, not a process of selection.

20 Virtual Virginia, that's just a phrase that VEDP is using, but it is the process of adjustments
21 that we are going through to react to these changes in the marketplace, and we are clearly focusing on
22 the consultant community. They are critical to us, and they are critical to the tobacco region. Mr.
23 Chairman, that is one of the things that we are really focusing on that we think will be extremely helpful
24 as we work together to change that economy that you have talked so much about. We're doing more
25 electronic monitoring to consultants, we're in the process of establishing a consultant advisory council.
26 We're focusing on them, because they've got the better projects, they're better qualified, and that's not to
27 the exclusion of others, but they're receiving the focus.

28 A second focus that we're working on deals with the use of the Internet. We have to put more
29 and better information on the Internet, labor information. Mr. Day, you asked a question before about
30 what factors are important. To us it's pretty simple. It's labor, it's labor, it's labor. It's all the factors of
31 labor. It's availability, it's education level, it's the opportunities for continuing education, and it goes
32 right on down the line, the number of people in a community that have a GED or do not have the
33 equivalent of a high school education. That's all information that can be gathered off the Internet like
34 that, and prospects and consultants form their opinions of a community and labor based on that. In our
35 view that's clearly the number one issue.

36 We're using more automation, and it's clear that we all have to do that. I think the third bullet
37 on that slide, the comparative view of our competitors. We always try to find out what our competitors
38 are doing or if they're doing it more, better, faster, and we're having to do the same thing. Certainly, one
39 of the issues that we need to address deals with the incentive issue, and one of the things we're finding,
40 and one of the things that consultants are telling us, is keep the time frame short. Tax credits aren't
41 anywhere near as important as grants, and we all understand that. I think those are the issues that we
42 have to bear in mind and move forward on.

43 Mr. Chairman, changing gears just a little bit, I'd like to talk about some of the partnering we
44 have done with the Tobacco Commission. Certainly the fall race at Bristol was a major one. The

1 Commission supplied funding to the two regional groups in Southwest Virginia, and we assisted with
2 that, and it was a wonderful event. There were fifteen companies represented with seventeen different
3 people from those companies, and we're particularly pleased with the cooperation that we received from
4 the private sector with those suite holders there that were very instrumental in helping us through that.
5 Right now we have five active projects from seventeen companies that were part of the Bristol event.
6 As you all know as well, we're jointly working on the OEM Automotive Site Study, and that has moved
7 very dramatically. I believe, Carthan, we're down to hopefully a final consulting firm that will guide us
8 through that. Ned, I believe you were in some of the final discussions and negotiations with that firm.
9 We're very excited about that, because Virginia simply does not have a site at this point in time that
10 could qualify, in our view, for an auto facility.

11 We also want to thank the Commission Staff for participating in what we call the Opportunity
12 Region Advisory Committee. The last session of the Assembly appropriated a half a million dollars to
13 VEDP to work with, or the budget term was distressed areas, and we prefer to call it opportunity
14 regions, but the Tobacco Commission, Ned and Carthan were very helpful to us and gave us ideas and
15 sharing information with us. One of the things very specifically that we're doing with those opportunity
16 regions, or with the Opportunity Region funding, is that we've hired a project manager who will do
17 nothing but market to industries that have the best opportunity to locate in those regions. We would tie
18 in very much with the work that Chris talked about and work with the local and regional analysts to
19 identify those companies, but our marketing manager would only be marketing, as opposed to only
20 marketing working projects, Mr. Chairman.

21 SENATOR HAWKINS: Let me ask a question dealing with how we approach
22 economic development. It's always well and good to go out and hunt buffalo, and I think we've talked
23 about that before, and be able to bring back these large industries to a locality. When you start looking
24 at the stability of our economies and stability of our communities, what are we doing to create new
25 ownership, new board rooms, new dynamics within the community where you start out small and you
26 build large? Are we attracting new ideas like nano-technology and other things, and are they beginning
27 to locate into these areas to grow employment and grow ownership? Because if you don't own anything
28 you don't control anything, I mean the bottom line.

29 MR. KILDUFF: Mr. Chairman, I sort of have two answers to that. One, I think
30 Secretary Schewel could talk very clearly about a new proposal that has come forth from the
31 Administration that will address in many ways the entrepreneurialship development that, grass roots
32 building.

33 The second area is something we're doing right now dealing with, you mentioned dealing
34 nano-technology and identifying those types of industries that have the greatest growth potentials that
35 really don't exist right now. Working with Virginia Tech and working with our institutions of higher
36 education, trying to identify those, and then work like the devil to get those to come to Virginia, or to
37 spin off from the universities into Virginia, as the one did in Danville.

38 SENATOR HAWKINS: Any questions? Yes, Mr. Day.

39 MR. DAY: What I call the traditional shell building model, has that become
40 obsolete?

41 MR. KILDUFF: I do not believe it is obsolete. We have changed the shell building
42 program to what we call the virtual building. By that, a community would identify a site and have a site
43 under control but would go through everything necessary but the construction of the building. It would
44 be designed, the planning process would be gone through, a contractor would be under obligation for a

1 six-month period to build the building at a fixed price. It gives the community a leg up on those that
2 don't have anything, but it stops short of them having to make the investment or through the state
3 program putting dollars out and let it be vacant for two, three or four years. On average in good times
4 shell buildings are vacant from twenty-four to thirty-six months. In more difficult times it's a longer
5 period. We think this is a smarter way of doing it, rather than going ahead and constructing the building.

6 SENATOR HAWKINS: Senator Wampler.

7 SENATOR WAMPLER: Thank you, Mr. Chairman. Mr. Kilduff, I guess in the
8 eighteen years that I have been here we've invented and re-invented, polished up certain initiatives, and
9 in light of your comment I think the Commission would be, speaking for the Southwest region I cannot
10 recall many deals that were closed that did not have the Tobacco Commission as a major bill-payer or
11 providing that incentive package. Would you generally agree with that?

12 MR. KILDUFF: Senator Wampler, I have some statistics later, I don't have it
13 broken down between the two parts of the tobacco region, but for the last year I do have those statistics
14 that show the relationship between GOF and TROF.

15 SENATOR WAMPLER: I guess the point I'm trying to make is that now the
16 Partnership and the Commission must work together for critical mass to do the deal.

17 MR. KILDUFF: Yes, absolutely, I'm a hundred percent in agreement.

18 SENATOR WAMPLER: Without trespassing on the Commission's time, or anyone
19 else in the audience, it's probably that time of year where we would offer a very kind invitation to come
20 to the Southwest delegation meeting and talk about the number of prospects within the regions so we
21 would have a better understanding of what success or areas of improvement that we might be looking
22 for. I would most graciously extend that invitation to you.

23 MR. KILDUFF: I most graciously accept it, sir.

24 SENATOR HAWKINS: While we're at the point of working together with
25 partnerships, may I make the suggestion, and I hate to put you on the spot, but I will. Is there anything
26 we can do fairly soon to work with Charlotte County and the Tobacco Commission to try to do
27 something to bring good news to that area? The loss of these jobs is going to impact them tremendously,
28 and we need to do something fairly rapidly. If there is anything that you can pull out of your hat it
29 would be a great deal of help working with Commission members and Staff to try to come up with
30 something.

31 MR. KILDUFF: We'll be happy to do that, Mr. Chairman.

32 Mr. Chairman, let me move on then rapidly here.

33 SENATOR HAWKINS: About how much longer do you think you need?

34 MR. KILDUFF: Maybe two or three minutes.

35 SENATOR HAWKINS: Fine.

36 MR. KILDUFF: This last thing deals specifically with TROF, and I want to
37 address head-on any misconceptions that there may be about TROF. We view it as one of the incentives
38 that's possible, we don't view TROF as the first incentive that's put on the table. We view it as one of
39 those things that may be necessary to close the deal, and that's the same way we view the Governor's
40 Opportunity Fund, one of those things that may be necessary to close the deal. I think it is in our joint
41 interest to only put the amount of resources on the table that is necessary to close the deal, and not one
42 nickel more. We do have and I'll be happy to share, and I think Carthan and Ned have them, but I'll be
43 happy to share them with the Committee. We do have written guidelines that our project manager uses
44 in terms of following the procedures of the appropriate use of the TROF funds. I want to assure you

1 right off the bat we just simply don't slip that out on the table and say, if you come here we'll give you
2 this, because it's not ours to give.

3 Second of all, we don't think that's the proven way of handling the incentive issues. You put
4 what's necessary on the table to produce the deal, and we try to follow those guidelines. The one point
5 that we try to emphasize and localities sort of want to walk up to one of you and say, I've got this
6 wonderful project, and you nod and say, I'm sure that's a good project and all of that. A lot of times our
7 localities think that is okay. Our procedures and rules require us to tell the localities to get ahold of Ned.
8 When we find out about a project and we understand working through the communities that they're
9 going to apply for TROF, our project manager tells the community to talk to Ned, and we also notify
10 Ned that it is our understanding. So I just wanted to get that point out. We view GOF and TROF as
11 good deal closing opportunities, and we don't put TROF out there right off the bat.

12 Let me move right ahead, Senator Wampler, this will address some of your questions. Last
13 year there were twenty-three projects involving GOF and TROF and of those twenty-three, sixteen used
14 both TROF and GOF. Those TROF projects that did not receive GOF, their average investment was 1.6
15 million dollars, which meant that they were under the statutory requirement for the GOF. That most
16 likely was the reason that GOF was not used in those other requirements.

17 I would point out that I think the numbers tell a good story for those sixteen projects that GOF
18 was using in the tobacco region. The average grant was \$1,900.00 per job, the average statewide since
19 the program began was about 1367 jobs. I think it's a focus that there are areas that need more help than
20 others. I would also point out that the 4.4 million GOF that was spent in the tobacco region was 37
21 percent of the total approvals for FY2004.

22 One final slide, Mr. Chairman, I think this all would make both of us and all of us feel good,
23 that the return on investment from TROF and GOF projects over a ten-year period of time, the net
24 present value returned to Virginia of that roughly ten million dollars is 33.4 million dollars.

25 Thank you, Mr. Chairman.

26 SENATOR HAWKINS: Thank you. As we all know, the change in the federal
27 trade laws, you'll probably see more and more pressure on what's left of our textile industry and those
28 jobs being created being offset by the losses that we're seeing, and we've got to figure out something we
29 can do. We look forward to working with you, and thank you for coming.

30 MR. KILDUFF: Thank you, Mr. Chairman and members of the Commission.
31 Again, I want to emphasize how much we do appreciate your support and willingness to be full partners.

32 SENATOR HAWKINS: Carthan.

33 MR. CURRIN: Mr. Chairman, back to the Allocable Share Legislation. John
34 Rainey, with the Philip Morris group, and there are various individuals that are going to make a
35 presentation.

36 MR. RAINEY: Mr. Chairman.

37 SENATOR HAWKINS: Yes, sir.

38 MR. RAINEY: This is John Rainey with Philip Morris, and thank you for having
39 us here today, and members of the Commission. I'm pleased to have my colleague, Jeff Wintner, Mr.
40 Chairman, here today to discuss the Allocable Share Legislation and the need to have it passed in
41 Virginia to protect Virginia's Master Settlement payments and the great work that this Commission is
42 doing.

43 If I may introduce, Mr. Chairman, Jeff Wintner.

44 SENATOR HAWKINS: You certainly may. Welcome, sir.

1 MR. WINTNER: Thank you, Mr. Chairman, and members of the Commission.

2 My name is Jeff Wintner, and I serve as counsel to Philip Morris USA. On behalf of PM USA, I'd like
3 to thank you, Mr. Chairman, and members of the Commission for the opportunity to speak with you here
4 today.

5 Because the Commission is already familiar with a lot of the background behind the Allocable
6 Share issue, and because I realize the time is tight, my thought was just to go over that background very
7 briefly and then to answer any questions that members of the Commission may have.

8 I believe the Commission is fully familiar with the problem that exists with the
9 Commonwealth's existing escrow deposit law, that that escrow law as written contained a loophole, that
10 this loophole allows non-participating companies or companies that haven't signed yet to avoid up to 98
11 percent of the escrow payments that the statute intends for them to make, and that as a result of this,
12 every year the Commonwealth is losing a large and ever-increasing amount of its MSA payments. And
13 so, like I said, I don't think there's an issue about whether there is a problem; the issue for us today, how
14 best to fix that problem, how best to safeguard the MSA payments. PM USA believes that the best, in
15 fact, the only way to fix this problem would be the Allocable Share Amendment. That's what the
16 National Association of Attorneys General concluded in endorsing the Allocable Share Amendment as
17 the way to fix this problem. That's what forty MSA states have concluded themselves in a national --

18 DELEGATE HOGAN: Let me interrupt you. Is it forty states, does that also
19 include the territories?

20 MR. WINTNER: Yes, it does.

21 DELEGATE HOGAN: It's not forty states.

22 MR. WINTNER: It's thirty-seven states, as we would normally define states. The
23 MSA defines states to include territories.

24 SENATOR HAWKINS: We are talking about things other than the states?

25 MR. WINTNER: Yes, it's thirty-seven states out of forty-six states, as we would
26 normally define states, that are joined in the MSA that have enacted Allocable Share, and three of the six
27 territories, and that's where I got my forty number from. And they've come to the conclusion that the
28 Allocable Share Amendment is the best, in fact, the only way to fix this problem. The reason is that it
29 fixes the problem the simplest way possible, through a small change in the language of the existing
30 escrow law to close the loophole. By addressing the problem through a simple linguistic change in the
31 existing law, it preserves the basic structure of the escrow statute, preserves the basic structure of the
32 MSA, and for that reason it doesn't do any damage or violence to the MSA or create any threat, potential
33 threat to the MSA's continuation of the economy.

34 Now, the same can't be said for the alternative tax proposal that was made before the General
35 Assembly sub-committee on the issue back on December 9, and may be discussed here today. In fact,
36 the opposite is true with respect to that proposal. The reason is that proposal doesn't fix the problem or
37 do anything within the structure of the existing MSA and the existing statutory structure. Rather, that
38 proposal is to create an entirely new cigarette tax applicable to all companies, including those that have
39 signed the MSA, and then to overlay that tax on top of the MSA and the escrow law. As a result of this,
40 that tax would be violating the MSA structure and would create a serious risk of the MSA's termination
41 from the Commonwealth.

42 I'll explain why in a moment, but at the outset I'd like to underscore that I'm not the only
43 person saying this. Attorney General Kilgore has directly opined on the issue of alternative proposals to
44 Allocable Share, such as this proposal. In a letter dated December 8 to Delegate Albrow, here's what he

1 said on the subject, and I quote: "Any alternative proposals, such as assessment fees against cigarettes
2 sold in the Commonwealth, could lead to legal action that could threaten the loss of Virginia's annual
3 payments under the MSA." Now the reason he came to this conclusion, we believe that he's right on the
4 subject, is that the tax would purport to override or abrogate central contractual provisions of the MSA.
5 And I'll give you a few examples of that.

6 First of all, it would abrogate a series of payment adjustments and credits that the MSA
7 provides for all existing companies, including Philip Morris USA. An example of this is that if a
8 participating company is required to pay certain money to cities or counties or municipalities for certain
9 specified reasons, we would get a credit against our MSA payments. So that we don't have to pay the
10 same money twice, we don't have a double payment. The way the tax works, however, we would just
11 have to make up that adjusted payment in the form of additional tax payments, so we would have to pay
12 that. It would abrogate that adjustment and increase our payment obligations. That's number one.

13 Number two, it would work a further increase in PM USA payment obligations by calculating
14 payments in an entirely different way and overriding the manner in which payments are calculated under
15 the MSA. Under the MSA we make a single nationwide payment, all participating companies make a
16 single nationwide payment, and each state gets a stipulated share of that, it's called Allocable Share
17 Assessment, is where it came from. Virginia's share is approximately two percent or a little higher. The
18 tax, however, would be calculated on the basis of in-state volume, and so a credit against the tax, as I
19 understand, was proposed back on December 9th in the amount of the MSA payment that you make to
20 the state, the Commonwealth, for any company such as Philip Morris USA that sells more than two
21 percent of its nationwide volume in the Commonwealth of Virginia, the credit does not fully defray the
22 tax, we owe them additional money.

23 The third way that this abrogates provisions under the MSA, it doesn't directly concern PM
24 USA, is that it would abrogate a grandfather share provision under which those smaller companies who
25 signed the MSA immediately, in the first 90 days, got their existing market share grandfathered. This
26 proposed tax proposed on December 9th would override that, abrogate that as well.

27 So why does this matter? Why does this create a threat to the MSA?

28 The MSA is a contract, and like any contract it lists its material terms. The MSA specifically
29 provides that every one of the adjustment and payment terms that I just described is a, quote, non-
30 severable term of the MSA, the term it uses, and the MSA goes on to provide that if a non-severable
31 term is abrogated in a state, that gives rise to a claim that the MSA should be terminated in the state.
32 And that's what the Attorney General was talking about in his letter when he said that if alternative
33 proposals along these lines, and again I quote, "could lead to legal action that could threaten the loss of
34 Virginia's annual payments under the MSA." We agree with that analysis, we want to avoid that result,
35 we are committed to the MSA, and for that reason we support the Allocable Share Amendment as a way
36 to fix the problem and to safeguard the Commonwealth's MSA payments.

37 SENATOR HAWKINS: Any questions? Mr. Day.

38 MR. DAY: Thank you, Mr. Chairman. Sir, what is your advocacy to raise the
39 retail prices of your competitors' products?

40 MR. WINTNER: I think that would be up to them, but what we're dealing with
41 right here is a situation where they can avoid up to 98 percent of the escrow deposits that the
42 Legislature, in enacting the escrow statute in the first place, intended for them to make. So I think it's
43 fair to say that if they are now not avoiding those escrow deposits, that may have an impact on retail
44 prices.

1 SENATOR PUCKETT: You made reference earlier to the escrow payment and the
2 loophole, and you made a statement that because of that loophole we're losing a large portion of the
3 MSA payments. Are you attributing what we're losing solely to the loophole, or are there other factors?

4 MR. WINTNER: There are other factors as well.

5 SENATOR PUCKETT: What would those other factors be?

6 MR. WINTNER: Well, there are other factors, including the general decline in the
7 amount, total volume of smoking is down in this country, and the fact that even with the Allocable Share
8 Amendment, that would narrow the price gap, that would narrow the gap between what the largest
9 companies have paid and what smaller companies have paid. There are other elements, but this is a
10 substantial contributing factor to what has been a very large and ever-increasing annual loss of MSA
11 payments.

12 SENATOR PUCKETT: Are you saying that the loophole is the single most
13 significant factor in the loss of payments from the MSA?

14 MR. WINTNER: It's difficult to quantify that, sir, but I am saying it is a very
15 significant component of it.

16 SENATOR PUCKETT: But you're not saying that it is the most significant?

17 MR. WINTNER: I can't quantify that, sir.

18 SENATOR PUCKETT: One other question, Mr. Chairman. You made reference
19 also to the other tax plan, and I assume we're going to hear something about that later, but you indicated
20 that something that might give rise to a complete change in the MSA agreement, if I heard you right, you
21 used non-severable term. Could you elaborate on what's out there that might cause the MSA, if we
22 chose to do something with the tax plan, what's out there that might cause, is there a legal opinion, or is
23 there a court case, or is there something on record, or is this just someone's opinion?

24 MR. WINTNER: Well, it's Attorney Kilgore's opinion.

25 SENATOR PUCKETT: Is that in writing? I heard you refer to the letter, but is that
26 the Attorney General's opinion?

27 MR. WINTNER: It's in the form of a letter. The reason there haven't been any
28 court cases is nobody has tried to abrogate a non-severable term with the MSA, and that's why forty
29 MSA states, or thirty-seven states I should say, have fixed the problem through the Allocable Share
30 Amendment, and none of the MSA states have tried to adopt some tax proposal or alternative measure
31 that would abrogate an MSA term and create this risk to their state that the MSA would be terminated.

32 SENATOR PUCKETT: I don't need to see the letter, but I would like for you to
33 answer the question. Is that an official legal opinion, or is that just a letter from the Attorney General?

34 MR. WINTNER: It's just a letter on his letterhead.

35 SENATOR PUCKETT: It's not an official legal opinion?

36 SENATOR HAWKINS: Now you're getting into a running debate that we
37 probably need to avoid.

38 SECRETARY SCHEWEL: I take it, sir, that what you anticipate if this contract is
39 abrogated the way the issue would arise would be a participant, a party to the contract, would sue for
40 breach of contract, saying the contract had been breached and therefore was void.

41 MR. WINTNER: Yes, that's correct. In fact, the MSA specifically provides for that
42 mechanism in what's called its severability and termination clause, provides a mechanism you think a
43 non-severable term and identifies at great length what are non-severable terms has been abrogated then
44 you can seek termination of the contract in the state. There are a host of parties to this contract, dozens

1 of companies that are parties to it, and it only takes one of them to make that claim.

2 DELEGATE KILGORE: I guess the thing that I'm having the most trouble with
3 would be the subsequent participating manufacturers. Now they would pay less, they would be paying
4 less than others that would come in under this Allocable Share Agreement, this Allocable Share
5 Amendment if we pass it?

6 MR. WINTNER: Certainly that's not true with respect to all of them. There are
7 dozens of subsequent participating manufacturers. I think the number that I heard is somewhere
8 between forty-five and fifty of them.

9 DELEGATE KILGORE: Right.

10 MR. WINTNER: Now a sub-set of them, a minority of them, joined the MSA right
11 away, between ten and fifteen of them joined the MSA within the first ninety days. They got a
12 grandfather share as an incentive for joining immediately to make payments to the state, which they
13 have been making from the get-go, for the last six years.

14 DELEGATE KILGORE: So that was the deal that was worked out?

15 MR. WINTNER: Yes, it was a deal we offered to all companies at the outset. If
16 you want to come under the MSA at the beginning, make payments from the get-go, yes, you would get
17 your existing market share grandfathered.

18 DELEGATE HOGAN: You spoke about the intent of the escrow statute; it would
19 be people making full payments because of what you define as a loophole, they are not making those
20 full payments, that was not the intent of the statute. My understanding is that Virginia receives about
21 two percent of the Master Settlement Agreement from the participating manufacturers, and the escrow
22 payment as defined is exactly identical to the two percent that Virginia receives, and that's based on
23 market share and other things like that. So the statute pretty clearly says, from my understanding, you're
24 going to make an escrow payment equivalent to the Master Settlement payment to the State of Virginia.
25 On what basis do you make the comment that was not the intent of the statute as it was originally
26 written?

27 MR. WINTNER: What I believe the intent of the statute was, the intent of the
28 provision that gives rise to what I term, is that there is a provision in there that is designed to say that
29 this statute can't be construed as saying that you should make more in the way of escrow deposits than
30 you would if you were a participant in the MSA and paying nationwide. The problem is the way that
31 provision is drafted. Instead of comparing your escrow deposits on a per-pack basis to what you would
32 pay nationwide under the MSA, if you were a party of the MSA, you would be making a single
33 nationwide payment on a nationwide volume. Instead of making that comparison, which was a
34 comparison intended, it makes a comparison between what the state receives under the MSA, and that
35 creates a disconnect, and that is what allows a company to withdraw immediately up to 98 percent of the
36 money that it is supposed to put into escrow. It is a strange statute indeed that says on the one hand
37 we're going to create this requirement, but on the other hand we're going to allow you to take out 98
38 percent of what you're supposed to put in, and that's why I say it was a loophole.

39 DELEGATE HOGAN: Just make a statement, make a comment to you. You all
40 don't write that statute to start with. It's my understanding, it's a little hard for me to understand how
41 you wrote something that's different from what you intended to do, but the statute does say that, the
42 escrow statute says make a payment equivalent to the state's receipts, very clearly the statute, that's what
43 it says, how can the intent of that be different from what it says?

44 MR. WINTNER: I think we're all familiar with situations where a statute is

1 enacted by a legislature and is based on, and something comes up in the aftermath of that statute nobody
2 contemplated when the statute was written. Now, I'm not saying that it doesn't comply with the statute,
3 to take out up to 98 percent of the escrow, it does. The problem is not that there has been a violation of
4 the statute there, the problem is the way the statute is written.

5 SENATOR HAWKINS: Mr. Owen

6 MR. OWEN: In response to Senator Puckett's question, you spoke first about the
7 decline of the overall MSA payment, but that doesn't speak to its adjustment for Virginia. Are there any
8 other factors other than this escrow account that cause Virginia's share to be adjusted off this more or
9 less two percent?

10 MR. WINTNER: I think there are additional other potential factors. I think this is
11 the most direct one and tangible in that it's going to happen.

12 MR. OWEN: And it's happening today?

13 MR. WINTNER: It is happening today.

14 MR. OWEN: How much has Virginia's MSA's payment been reduced in this
15 period by this effect?

16 MR. WINTNER: I have to break that down into a couple of components. The
17 growth of market share of non-participating manufacturers has gone from, in 1998 when the MSA was
18 signed, a small fraction of one percent to approximately ten percent nationwide now, and it's continued
19 to grow, is greater than Virginia's, is my understanding. That produces a direct impact on MSA
20 payments, because the MSA payments are tied to participating companies' volumes. So a shift from a
21 participating company to a non-participating company takes money straight out of the pockets of the
22 states.

23 MR. OWEN: Volume overall, I think that's right.

24 MR. WINTNER: Well, that's part of the overall picture. Another way that MSA
25 payments decline, to give you the whole thing in context of the overall picture, is the overall value,
26 everybody's. Then there's the diminution. This shift to NPM, which is what I'm trying to quantify for
27 you to try and answer your question, I believe the number that I have seen from last year was that this
28 shift in market share from the NPM's profit, the Commonwealth, I think it was twelve million dollars,
29 and as that number continues, as that shift continues, that number will continue to grow.

30 SENATOR HAWKINS: Okay. Now, I'm not trying to be impolite, we're going to
31 run out of time today, we've got another viewpoint that has to be presented today. I'm going to take two
32 more questions from Senator Puckett and Delegate Wright, and then we'll go to the next group.

33 Senator Puckett?

34 SENATOR PUCKETT: Jeff, I don't want to put words in your mouth. If I'm
35 saying something wrong or asking the wrong question you can tell me real quick. Did I understand you
36 to say that in your opinion the only way to fix this problem is through the Allocable Share Legislation?

37 MR. WINTNER: The only way to fix the problem and to safeguard the MSA and
38 the MSA payments without doing violence to the MSA, and creating this risk that I talked about, yes.

39 SENATOR PUCKETT: Key word there, risk. You don't know that, though, do
40 you?

41 MR. WINTNER: I know there will be a risk.

42 SENATOR PUCKETT: You know there is a possibility there?

43 MR. WINTNER: I think that there would be a very serious risk to the continuation
44 of the MSA.

1 SENATOR PUCKETT: Do you not have any opinion that there might be another
2 way to fix this without the Allocable Share?

3 MR. WINTNER: I can point you again to Attorney General Kilgore's letter in
4 which he says --

5 SENATOR PUCKETT: -- Thank you --

6 MR. WINTNER: -- in which he says any alternative provision might create that
7 risk.

8 SENATOR HAWKINS: Delegate Wright?

9 DELEGATE WRIGHT: Mr. Chairman, I have one question, please. If a way was
10 found to have a tax rather than an MSA payment is it true that the State of Virginia would be better off,
11 for instance, if the tobacco companies had a way including bankruptcy to avoid MSA payments, would
12 they still be liable for the tax payments? So would the state actually be better off, and the Tobacco
13 Commission, if the money was still coming in, rather than not getting any?

14 MR. WINTNER: Everything is premised on the if, that was the beginning, that
15 was the premise of your question. And all the other states that have enacted Allocable Share, they've
16 considered other approaches. Like this tax proposal, the concept of it is not new, other forms of it were
17 discussed and potentially even introduced in a bunch of these other states, and they all came to the
18 conclusion that it created too large of a risk to the continuation of the MSA, all of the dollars that that
19 means to the state and all the public health benefits and they went the route of the Allocable Share, and
20 we urge you to do the same thing.

21 DELEGATE WRIGHT: Is the answer to my question yes or no? If the answer is
22 yes, if there was a risk-free way to do it, isn't it true that there would be less risk to the state by getting
23 the tax rather than depending on the MSA payment, which could be jeopardized by bankruptcy; is that
24 not a true statement?

25 MR. WINTNER: If there is a risk-free way that does not present any threat to the
26 MSA, I think the answer to your question is yes, it would address certain other issues.

27 SENATOR HAWKINS: Thank you, and we'll have obviously many opportunities
28 to continue this conversation as the session progresses.

29 MR. JOHNSON: Thank you, Mr. Chairman. Some of you I know, some of you I
30 have met, and some of you I have never had the pleasure of meeting. I'm Scott Johnson, I live out in
31 Hanover County. Don't hold it against me, but I'm one of the lawyers, too. I'm going to try to introduce
32 who we're here for. You've heard from a well-respected corporate citizen, but I want you to hear on
33 behalf of a very small business in Keysville, Virginia, and that's who I have the privilege of representing
34 with Mr. Ernie Gellhorn, and we're going to talk a little bit about that. Permit me if I can, not to trespass
35 on your time, because I know your hips are as sore as mine from sitting.

36 Let me take you through a roadmap of where we're going. Number one, we're going to tell
37 you about S&M Brands, and who S&M Brands is. Number two, we're going to give you a solution that
38 we firmly believe works. It differs from a proposal that you just heard about. Delegate Wright asked
39 the question over there a second ago about a steady revenue stream to Virginia. Our solution gives to
40 Virginia that steady stream, a protected stream and a stream that we will show you can result in Virginia
41 getting in your hands one hundred million dollars.

42 Now first let me tell you about S&M Brands. You see the pictures up here, some of them
43 have got a little bit of age on them, but this began as Bailey's Tobacco, and you see Mack Bailey there
44 on the left who I'll introduce in a second; some of his relatives started in Southside. Let's tell you where

1 they are. Starting in Keysville, Virginia out in Lunenburg County, five generations of tobacco farmers
2 employs two hundred and twenty-five people at their facilities now. One of the proudest things that we
3 have to bring to you is that they are true Virginians. They buy one hundred percent U.S. flue cured and
4 burley tobacco. If I may, Mr. Chairman, I'd like Mr. Bailey to please stand at this point in time so you
5 can see who Mr. Bailey is, and one of the things you may have heard if you read any of the newspapers
6 or seen any of the announcements, as of Friday S&M Brands announced that their plans this year is to
7 buy ten million pounds of Virginia flue-cured and burley tobacco.

8 SENATOR HAWKINS: Scott, how does this apply to the import market, cigarettes
9 made offshore? That's a question I just haven't had a good answer to.

10 MR. JOHNSON: One thing about it, Mr. Chairman, with the solution that we have
11 before you it will allow S&M Brands to continue to buy Virginia grown tobacco; without a solution like
12 this, then the alternative is not to buy Virginia tobacco and to have buy Brazilian tobacco, which would
13 save S&M Brands approximately five million dollars, and that's not something they want to do. They
14 want to stay in business to support Virginians.

15 The second answer to your question is the foreign tobacco that comes in, we're creating a
16 level playing field with the foreign companies, so we're trying to make sure the foreign companies
17 would owe Virginia the same thing that S&M Brands would, and owe Virginia the same thing that the
18 larger companies would.

19 SENATOR HAWKINS: It's not so much tobacco, it's the offshore manufacturing,
20 too, that we begin to see more and more of, and I just wonder how they fit in the mix; I know you don't
21 represent any of those companies.

22 MR. JOHNSON: Yes, sir.

23 SENATOR HAWKINS: It's part of the overall mix.

24 MR. JOHNSON: Yes, sir. They would have the same excise tax applied to them as
25 would the local growers and the larger companies in Virginia. Mr. Chairman, if I could introduce at this
26 point in time Mr. Ernie Gellhorn, and while I'm just a local guy, for any of you that like Blue Devil
27 basketball, Mr. Gellhorn was Dean of the Law School down at Duke. He's been dean at three schools,
28 he teaches Constitutional law. He's an expert in this area, and it's my pleasure to introduce my friend,
29 Ernie Gellhorn.

30 SENATOR HAWKINS: Welcome, sir.

31 MR. GELLHORN: Thank you very much, Mr.
32 Chairman. Before I go into our presentation I'd like to answer some of the specific questions that were
33 presented to you, because I think they can be answered quite pictorially. First of all, the Allocable
34 Share Amendment proposed by NAG increasing the cigarette price, the answer is yes. The average
35 price paid by the NPM in terms of the escrow is a dollar per carton. Under the Allocable Share
36 Amendment it will go to four dollars, so that will be an increase of cost of three dollars per carton, and
37 unless you're willing to take a loss you're going to have to pass that on to the consumers.

38 The second point I would make is --

39 SENATOR HAWKINS: -- Is that an overall increase, or just that particular market
40 that we're talking about, which are the brands that are not members of the MSA?

41 MR. GELLHORN: It will be for the non-participating manufacturers and for the
42 grandfathers; excuse me, it'll just be for the non-participants, but remember they are the ones who
43 produce the low cost products that's primarily bought by the poorest citizens of this Commonwealth and
44 every other state. They are the ones that are going to be most affected.

1 Second, they're suggesting that you cannot do anything else that might have any impact on the
2 MSA. But oh, yes, you can change the escrow deposit part of the statute. It seems to me a deal is a
3 deal. If you created the deal that says there's a limit on the escrow statute, to change that is a
4 modification. We happen to think that, and that's not going to stand, it's legally vulnerable. It has been
5 challenged in the State of Oklahoma. And last week, the 5th of January, the district court issued a
6 temporary restraining order. It has been passed in New York, and on September 18th, earlier last year,
7 the district court in New York enjoined that statute, and yesterday a representative told you that that
8 statute is not going to survive review, or that that injunction is not going to survive review in the court of
9 appeals, and let me tell you they got it wrong, because it will survive. Why? Because the state didn't
10 appeal it. There has been an appeal on other parts of the court's order, but not on the injunction of the
11 Allocable Share Amendment. Likewise, the State of Louisiana has an Allocable Share Amendment that
12 is currently in litigation in the district court. It has been challenged, the court is taking that challenge
13 under advisement; we're waiting for a decision.

14 With that background let me move specifically to the points we were wishing to make. What
15 I'm going to present today is first of all what is the legislative proposal related to? It's not complex, but I
16 think it is fair. I want to explain how it works, and I want to identify, in contrast to the Allocable Share
17 Amendment, that this produces additional revenue for the state, we're going to suggest at least a
18 hundred million dollars annually. Now the benchmarks that we use for this is to make sure that what we
19 do is fair to every manufacturer. You'll see that our proposal applies the very same amount for every
20 manufacturer. We don't distinguish between subsequent participating manufacturers, original
21 participating manufacturers or non-participating manufacturers. Second, we seek to assure through this
22 mechanism that there will be continued payments to Virginia because, as was properly noted, we're
23 proposing an excise tax, which is not voidable in bankruptcy. And third, we're proposing, in contrast to
24 what was presented to you a moment ago, no change to the MSA. Ours is a separate proposal for
25 change in the Virginia statute, which takes into account the MSA, but does not itself change the MSA.
26 And therefore I think it is not vulnerable to Constitutional challenge, or in fact any contractual
27 challenge.

28 Okay. What's our solution? Well, first of all it is that the State of Virginia would adopt an
29 excise tax of four dollars per carton on all manufacturers. Everybody would be obliged to make that
30 payment. There's nothing hidden about, there's nothing complex, essentially one sentence to the
31 Virginia Statute. Okay. Then second, how do we blend this with the MSA to make sure that nobody's
32 paying twice and nobody is caught in an unfair situation. Well, we think that in this bill credit shall be
33 given for any payment made under the Master Settlement Agreement. In other words, if you're paying,
34 as Philip Morris claims, four dollars per carton on its cigarette tax, it will get a credit for that four
35 dollars and end up paying no more. If on the other hand you're making a payment on your escrow
36 payment, you'll get a credit for that, but everybody pays the same amount. The final thing is
37 that we want to make no modifications but we want to create additional revenue for Virginia. Okay.
38 That's, I'm sorry, I skipped over one, I apologize, and that is we suggest that this money that comes into
39 Virginia which would be approximately fifty million dollars a year, be allocated to the Virginia
40 Healthcare Fund for medical assistance so that it can be matched by federal Medicaid. That would
41 obviously be up to the legislature's discretion, but that could produce a total of one hundred million
42 dollars for the Commonwealth.

43 Okay. Let's look at the payment structure. It is basically very simple. The original
44 participating manufacturers, Philip Morris, RJR, Lorillard, they owe four dollars, under the Master

1 Settlement Agreement, they get credit for four dollars, and they owe Virginia no more as a result of this
2 proposal. Second, we have the subsequent participating manufacturers. They would also owe four
3 dollars. Now, the grandfathered market gets an exemption for all of the cigarettes that they sold in 1998,
4 or a hundred twenty-five percent of what they sold in 1997, which means that they pay actually
5 considerably different amounts, Victory pays fifty-four cents, Liggett pays ninety, Wind River pays three
6 nineteen. On the average we figure about a dollar. So they get the credit for what they pay. They would
7 owe Virginia three dollars per carton. And then there's the group, Bailey's included, would also be
8 subject to the four dollars per carton.

9 SENATOR HAWKINS: Where does the consumer fit into this?

10 MR. GELLHORN: The consumer, they're currently paying, basically, the premium
11 manufacturers, about twenty-eight to thirty-five dollars a carton. The non-participating manufacturers,
12 low cost producers, they're selling at from eight to fifteen dollars a carton. They would see along with,
13 they would see an increase in their payments. We're proposing a tax on ourselves. Why? Because we
14 want a level playing field. Currently, we're playing up against the subsequent participating
15 manufacturers who pay very much less, and they have most of the low cost sales, in fact, they're the
16 ones who would welcome this. Does that answer your question?

17 SENATOR HAWKINS: Just that the consumer is going to pay the burden of what
18 we're doing and I don't want to get into a debate on this today, but the problem if we're trying to work
19 with the MSA payments based on the sale of domestic cigarettes and we keep prices going up that more
20 and more people would just walk away and you'd have less consumption, and you'd have a little
21 problem, in my mind.

22 MR. GELLHORN: Under the Allocable Share Amendment proposal, the consumer
23 also has to pay more. There's no difference on this. The difference is that the local smaller
24 manufacturer such as the Baileys in contrast to the Liggetts and the, are going to be put at a severe
25 competitive disadvantage, because the grandfathered subsequent participating manufacturers under the
26 Allocable Share Amendment cannot more.

27 SECRETARY SCHEWEL: Mr. Chairman.

28 SENATOR HAWKINS: Yes, sir.

29 SECRETARY SCHEWEL: Mr. Gellhorn, I'm sorry, I didn't understand what you
30 just said there. You said it would be the same thing under the Allocable Share Amendment in terms of,
31 the way I would understand it, correct me if I'm wrong, under the Allocable Share Amendment cigarettes
32 made by the non-participating members would, those manufacturers would have to pay more.

33 MR. GELLHORN: Yes, sir.

34 SECRETARY SCHEWEL: But the whole rest of the universe of manufacturers
35 would not have to pay more, so that in the tax proposal, the tax goes up on all cigarettes sold by all
36 manufacturers, that's your proposal. Under the Allocable Share Amendment proposal the price of a sub-
37 set of cigarettes, a small sub-set of cigarettes would go up, but they wouldn't go up for the rest of them.

38 MR. GELLHORN: No, that's incorrect. Let me explain, and I apologize for not
39 being clear on that. For the original participating manufacturers who already pay, they pay four dollars
40 per carton, they don't pay any more under our proposal.

41 SECRETARY SCHEWEL: I'm sorry, you misunderstood me. I didn't say that they
42 paid more, I said the consumer paid more.

43 MR. GELLHORN: The consumer wouldn't pay more, because they're not paying
44 more unless they're choosing to use that as an excuse to raise their prices. So there wouldn't be any

1 change. The original participating manufacturer faces absolutely no change.

2 SECRETARY SCHEWEL: How can that be so if they have to pay four dollars in
3 tax?

4 MR. GELLHORN: Because they get a credit, a full credit for their MSA payment
5 against their Virginia tax on their bills from the Department of Revenue would be zero. Now, let me
6 suggest this, I wasn't complete in my descriptions. And that is that under the Allocable share
7 Amendment the non-participating manufacturer has to pay now four dollars and does not get a tax
8 deduction. The tax deduction on four dollars a carton is a dollar sixty, but their costs are going to go up
9 by sixty under the Allocable Share Amendment. That's what's behind it. This isn't an attempt to create a
10 level playing field, this is an attempt to wipe out the non-participating manufacturers, and that's exactly
11 what the New York court found in Freedom Holding. They said that those states that had the Allocable
12 Share Amendment did not have, quote, a legitimate reason other than to do, quote, at the behest of the
13 original participating manufacturers. So what we're really trying to do is stop something that is just
14 grossly unfair and will not benefit the consumer.

15 SENATOR HAWKINS: Okay. Let me interrupt. Cell phones, if anyone has them,
16 please turn them off. Mr. Bryant.

17 MR. BRYANT: Sir, you are disputing the testimony that we just heard from the
18 attorney from Philip Morris stating that their payments go into a national fund, they're not just paying
19 on the basis of two percent that Virginia has. I don't understand you saying it's going to create a level
20 playing field and everyone is going to pay the same. You're in direct conflict with what has just been
21 testified by the participating manufacturers.

22 MR. GELLHORN: I'm suggesting that it
23 was a misleading aspect, I assume unintentionally, to that statement. Yes, they're making a payment in
24 of approximately four dollars on all of their cigarettes, and they get as a consequence all sorts of
25 protections, no immunities, no liabilities, immunity from lawsuits, et cetera. What we're suggesting here
26 is they will get a credit under the proposal that we're making for their payments to the MSA on their
27 sales in Virginia. What we're suggesting is that the very same amount would put them at a zero change
28 level where under our proposal the cost to the subsequent participating manufacturers that are currently
29 protected and grandfathered and pay a lot less as well as the non-participating manufacturers would be
30 obliged to make the same four-dollars-per-carton price. And it would be a tax; that's a consequence, it's
31 a tax, it would be a steady stream to Virginia. It would not be subject to bankruptcy exception, it could
32 not be voided in bankruptcy and that frankly is a real threat.

32 SENATOR HAWKINS: One more question.

33 MR. BRYANT: Was Bailey's allowed to join as an SPM at the very beginning of
34 the MSA?

35 MR. GELLHORN: Yes, and they were told what the terms would be and under the
36 terms they specified to. We're a tiny company, we're not going to be allowed to promote our product
37 under this scheme, we'll be frozen in basically to our tiny ship, and they were told that if they would not
38 become a participant they would pay an escrow amount which would release that money, the 98 percent
39 to the State of Virginia, and it is that term of the deal that is being changed unilaterally, contrary to the
40 statements made by Philip Morris' then attorney, a man by the name of Mr. Wright, as stated in an
41 affidavit in the Freedom Holding Case. So yes, they were given a chance, they understood the terms,
42 they accepted those terms, and now an effort is being made to say we want to change those terms
43 unilaterally.

44 SENATOR HAWKINS: Mr. Walker.

1 MR. WALKER: Mr. Chairman, my concern is how this proposal would affect this
2 particular Commission. As you know we're funded through the MSA payments, and I'm wondering how
3 your proposal would flow money into this Commission so we could continue to help Southside and
4 Southwest Virginia?

5 MR. GELLHBORN: First of all you would be getting, you would continue to get
6 your MSA payments from the OPM and the subsequent participating manufacturers to the extent that it
7 has been in place. Those funds would come in. We were proposing that the fifty million dollars that
8 would be generated be doubled under the Medicaid proposal, but that, obviously, is up to you. You can
9 allocate additional funds for the Commission. The money that we are proposing in excise tax produces
10 revenue for Virginia. Note the process the Allocable Share Amendment being proposed by Philip Morris
11 is producing only for the escrow account the Commonwealth gets only if there is subsequent liability.
12 Whereas what we're proposing is an excise tax that raises and is matched by and produces an
13 additional total of a hundred million dollars for the Commonwealth.

14 SENATOR HAWKINS: I'm not trying to cut off the debate, but it's ten minutes to
15 twelve, and we need to be out of here at twelve o'clock. Can you wrap this up fairly quickly, sir, or not?

16 MR. GELLHORN: Yes. Let me go to two final points. One is the claim that was
17 just made this produces additional revenue for the state. It does it on a basis on which each
18 manufacturer would pay the same amount. It eliminates a dollar sixty tax disadvantage currently
19 suffered under the Allocable Share Amendment proposal by the non-participating manufacturers, such as
20 Bailey's. It would protect the revenue to the state because this would be tax not subject to be voided in
21 bankruptcy, and finally it would not be subject to legal challenge. The Allocable Share Amendment, I
22 would suggest to you, is highly vulnerable, and we expect, frankly, some decisions out of district court
23 saying that this does not pass Constitutional muster.

24 SENATOR HAWKINS: How does this all tie into the offshore manufacturing? I
25 go back to that. This discussion has to be expanded beyond what we're talking about, and we're talking
26 about competition in the market place, and you've got the offshore people that are coming in with
27 cheaper manufacturing. How does that fit into this?

28 MR. GELLHORN: Our proposal applies equally to the offshore manufacturer as
29 well as the on-shore manufacturer. Every cigarette sold in the Commonwealth of Virginia would be
30 subject to the excise tax.

31 SENATOR HAWKINS: But your first comment was that you could not bankrupt
32 this whole tax situation, but in fact if you're an off-shore corporation what control do we have over that?

33 MR. GELLHORN: Zero. And the offshore corporation can of course come into
34 the state, make a sale for the year, disappear and not make a payment the following year. That's not
35 uncommon, unfortunately, and it's not limited to offshore producers. Whereas, under the proposal we're
36 making that excise tax is collected like all other income taxes on a much more immediate and certain
37 basis.

38 SECRETARY SCHEWEL: Mr. Chairman?

39 SENATOR HAWKINS: Yes, sir. Mr. Secretary.

40 SECRETARY SCHEWEL: Mr. Gellhorn, you said that the excise tax wouldn't be
41 subject to legal challenge on the tax bill, et cetera. You're certainly not arguing, are you, that the MSA
42 wouldn't be subject to legal challenge because of it, you may be saying that you think that's a losing
43 argument, but you certainly must think, don't you, that it's likely to generate a challenge to the MSA
44 arising out of these kinds of things?

1 MR. GELLHORN: I don't think there's any legislation that I could draft today that
2 would be immune from legal challenge.

3 SECRETARY SCHEWEL: Well, you said it wasn't subject to legal challenge, it
4 seems to me you mean immune from?

5 MR. GELLHORN: I don't think it's subject to legal challenge, because an excise
6 tax, which applies equally, and which provides credit for existing conditions, is well recognized. Look
7 at the tax laws today. We have mortgage deductions, mortgage payment deductions. Some people have
8 a mortgage, others don't. Some get the deductions, others don't. A well-recognized mechanism of tax
9 revenue, that's all we've done.

10 SENATOR HAWKINS: Mr. Secretary.

11 SECRETARY SCHEWEL: I would argue it's a gross oversimplification, and so
12 your conclusion is that the Attorney General's conclusion on this point is wrong?

13 MR. GELLHORN: The Attorney General didn't provide a legal opinion here. He
14 gave a first-hand view of this, we had discussions with Mr. Ferguson in his office on it and raised some
15 of the same questions. We talked about them directly, and we both walked away acknowledging that
16 there are some issues that can be discussed. I don't read that letter, if you read all of the letter, it makes a
17 statement at the very end of it that suggests that this is going to have to be subject to further scrutiny and
18 evaluation before we can reach a conclusion. So I think it's wordy at this time.

19 SENATOR HAWKINS: Mr. Secretary.

20 SECRETARY SCHEWEL: One last question, I'm sort of troubled here in addition
21 by sort of a risk-to-reward ratio. I'm willing to accept the fact that the question of whether the MSA is
22 applicable is at least a litigatable issue and one on which there is going to be strong argument on either
23 side. We at least potentially run the risk, if that were abrogated, of losing all the MSA payments; in
24 exchange we get what you claim are the benefits of this. Why is that the right risk-to-reward ratio for us
25 to undertake?

26 MR. GELLHORN: I don't think you have a complete understanding. First of all,
27 the Master Settlement Agreement itself has been challenged in the State of Florida's litigation as a
28 violation of the anti-trust laws and equal protection, and in the Second Circuit, in a major opinion by
29 Chief Judge Quinn, ruled in connection with a motion to get rid of this case, saying no, this is a very
30 valid lawsuit. Indeed, he goes so far as to say, but for the fact that the states joined in this, the various
31 tobacco companies would have already had the pressing conversations with the U. S. Department of
32 Justice for violation of the anti-trust. So he says, look, if you look at MSA Settlement it has serious
33 legal problems. That issue is now in the process of being addressed, and there will be arguments during
34 the week of January 17th, next week, in the Second Circuit on that issue. That court also has said that
35 the Allocable Share Amendment itself is, looks to be in violation of the federal anti-trust laws, and the
36 district court enjoined it, as has now one other federal district court judge. I think we're going to see an
37 avalanche on this. So I would say first of all the MSA itself is not totally immune from challenge.
38 Second, the Allocable Share Amendment is at a high rate of risk, third, the excise tax proposal provides,
39 not only provides additional revenue, but is itself very difficult to challenge.

40 SENATOR HAWKINS: Anybody else?

41 MR. MAYHEW: Mr. Gellhorn, is it true that the SPM's have also entered into
42 agreement early on and thought the SPM's were going to follow through, would they may be harmed by
43 this tax increase?

44 MR. GELLHORN: Yes. No question about it, and they may have a claim against

1 the MSA. I don't think they have a claim against the Commonwealth, for adopting an excise tax,
2 because every one of the cases has said that a state can go ahead and adopt an excise tax. The only thing
3 they'd really be complaining about is these other people are getting more credit for payments they're
4 making to the MSA. But how can the SPM's be hurt or make any complaint that Virginia won't give
5 them a credit for a payment that their not making?

6 SENATOR HAWKINS: Delegate Hogan.

7 DELEGATE HOGAN: Mr. Gellhorn, I'd like to just go back to something that
8 Senator Hawkins asked you about. In terms of dealing with some of the offshore manufacturers and
9 how they're affected, my understanding is there's a significant number of the grandfathered SPM's,
10 people that get a discount on their payments are offshore, and if you were to pass Allocable Share the
11 effect of that could be that we would be passing a tremendous price advantage for offshore
12 manufacturers and taking away from our domestic manufacturers and I think the point that Senator
13 Hawkins was maybe asking about, and I wondered if you might speak to that.

14 MR. GELLHORN: To the extent to which there are offshore manufacturers that
15 are grandfathered under the Master Settlement Agreement, that certainly would apply. Personally, I
16 don't know anything about the specifics of that. I do know that the two majors, Liggett and
17 Com -- have primarily U.S manufacturing facilities.

18 SENATOR HAWKINS: Thank you, sir. I'm not trying to rush you, but we've got
19 some others. Thank you. We all have a better understanding and a fuller grasp of the problems, and I'm
20 sure we all have a solution to this, and I look forward to seeing how this will be done. We appreciate
21 your time.

22 DELEGATE WRIGHT: I have one comment.

23 SENATOR HAWKINS: Yes, sir.

24 DELEGATE WRIGHT: Earlier you spoke about the situation in Charlotte County
25 and how it affected them. I want to make it clear that S & M Brands is located in my home county of
26 Lunenburg and employs two hundred twenty-five people. We could make the same comment about
27 Lunenburg and how to replace those jobs if a rush to judgment is made on this Allocable Share
28 Amendment, so I strongly hope that we'll take a real strong look at any other options that are risk-free
29 that are out there.

30 SENATOR HAWKINS: Well, that's what we're here for, is to do that. What I
31 would strongly suggest is that although we will not make a recommendation today, all the participants in
32 this get together and come up with something that works and we need to get this thing finished.

33 MR. BRYANT: Mr. Ferguson, I'd like to ask you one question. Yesterday the
34 question was asked by Delegate Hogan about the position of the Attorney General, and we heard one
35 answer from a representative from that office, and we heard you speak about the letter that we heard
36 today. Is that the official position of the Attorney General? I want this body to hear that.

37 MR. FERGUSON: I think the best thing to do is read this letter, it's very short, it'll
38 take about thirty seconds. As I recall, this letter was written to Delegate Albo, and copies to Chairman
39 of the Senate and House Courts Committee.

40 SENATOR HAWKINS: It will be made part of the record.

41 MR. FERGUSON: This is a letter dated December 8th, addressed to Delegate
42 Albro. "Dear Delegate Albo: Currently tobacco companies known as non-participating manufacturers
43 or NPM's which are not party to the Master Settlement Agreement, MSA, sometimes obtain their
44 immediate relief of over 90 percent of their required escrow deposits, which results in a loss of millions

1 of dollars in MSA payments that would otherwise flow to the Commonwealth. One way to address and
2 correct this problem is to enact the Allocable Share Model Legislation that is the endorsement of the
3 National Association of Attorneys General. The Association adopted the Allocable Share as a policy
4 position at a meeting held in Williamsburg in December of 2003. To date forty states out of forty-six
5 states that are part of the MSA have enacted the Allocable Share Legislation. Any alternative approach,
6 such as assessment fees against cigarettes sold in the Commonwealth could lead to legal action that
7 would threaten the loss of Virginia's annual payments under the MSA. Therefore, Allocable Share
8 appears to be a viable course for the Commonwealth to take. Finally, I support and I encourage the
9 General Assembly to enact legislation that mitigates any adverse economic impact to employers
10 operating in Virginia as a result of the proposed Allocable Share Amendment. Very truly yours, Jerry W.
11 Kilgore."

12 To clear up any question I would note that this is not an official opinion of the Attorney
13 General in the way we view those. This is a letter expressing the Attorney General's opinion about it,
14 but is not an official opinion that would have any precedential value in a legal proceeding. I would take
15 a moment, Mr. Chairman, I think that you heard the advocacy position of both parties here today. I think
16 that some of the things Secretary Schewel has said, some of the things that other members have
17 commented on are accurate. I think that whichever, all advocacy positions there is some
18 oversimplification. There are statements, I think, from both parties, but I think that at the end day there
19 is a large loss of MSA payments to the state. Under the current system, I don't use the term loophole,
20 because like Delegate Hogan I believe that the statute was written the way it was intended to be written
21 at the time. We've had consequences that may have been unforeseen, but I don't believe that is a
22 loophole the way we traditionally think about it. I would say it is a significant risk of litigation if the
23 proposal from the NPM's goes forward. But I think there's also significant risk of litigation if the
24 Allocable Share passes. I think we would likely face litigation if any change if any change is made
25 whatsoever. I would not stand here and predict the outcome of any of that litigation. Just to clarify one
26 point on that, though, I would say that the MSA itself, while it is subject to challenge in New York, it
27 has been challenged in the Fourth Circuit here in Virginia and the escrow statute itself, not the Allocable
28 Share Amendment, both have been subject to challenge in federal courts here in Virginia and in the
29 Fourth Circuit, and it has withstood those challenges.

30 SENATOR HAWKINS: Thank you, sir. One final question.

31 DELEGATE HOGAN: I think the point that you made at the end is maybe worth
32 focusing on. I think we've been sued, we're being sued now under the existing law, so if you make the
33 Allocable Share change we're going to get sued, if you make this other change we're going to get sued.
34 So would you agree with the statement, or maybe comment on the statement, that the notion that these
35 proposals are not legitimate because the State of Virginia is going to get sued would apply equally to
36 every single one of them?

37 MR. FERGUSON: Well, I don't want to go quite that far, because I think it
38 probably would handicap the likelihood of success of a particular legal challenge is something any
39 lawyer who values his license wouldn't do. What I would say is this. I think that, the reason I say I'm
40 confident we would have potential litigations is because I have been told that by both parties, not just
41 both parties, there are multiple parties involved. SPM's haven't really spoken directly, heard by
42 deposition. But there are more than just two, at least three, four or five. What I'm trying to do is give
43 you an objective comment about things without, hyperbole, without the advocacy role and without
44 trying to necessarily persuade you one way or the other at this point. What I'm trying to say is I think

1 there is a risk of litigation in any event. I think there are claims to be made probably in any of that
2 litigation. I can't tell you that any one of them would prevail. Certainly our office would be in a
3 position of defending whatever change might be made. I think there are strong defenses for any of the
4 changes that might be made. Understand also, though, that the issue of whether or not the MSA might
5 be subject to attack is somewhat separate from the issue of whether or not a tax itself is legitimate. The
6 tax may be perfectly legally okay, but that still may give a basis, arguably, as refers to Philip Morris for
7 attacking or claiming that the MSA has been abrogated. So again it's not just one legal issue, it's just
8 not a matter of whether or not a bill that is passed is constitutional or not. It could be constitutional but
9 have repercussions beyond that.

10 SENATOR HAWKINS: Thank you, that's one of the advantages that Virginia has,
11 we have some of the finest law schools in the country. Any other comments? Anyone from the audience
12 like to make some comments? Going once?

13 Yes, sir. Would you mind identifying yourself for the record?

14 MR. LEVIN: My name is Peter Levin, and I'm with the National Association of
15 Attorneys General. I know the time is late and, Mr. Chairman and members of the Commission, I just
16 wanted to make a point or two, if I could. One is that we've heard, because we've heard that the state, as
17 I heard it, has a deal with S&M Brands that they shouldn't renege on. I'm not aware of any deal between
18 any state and S&M Brands. I am aware that there is a written agreement with participating
19 manufacturers, subsequent participating manufacturers, and as you've heard the proposal for this tax
20 certainly does engender a potential risk to the Master Settlement Agreement. You've also asked
21 about offshore manufacturing, and if the status quo continues then there is no question the rise in the
22 NPM market has been largely foreign manufacturers, and Virginia will be simply a magnet for foreign
23 manufacturers who want to take advantage of basically the Allocable Share release as originally enacted
24 and that will mean you've got cigarettes coming in not subject to the public health provisions, not
25 subject to full escrow payments, and that are most attractive to your youngest smokers, the youth, and
26 that seems to me to be a point that has not been addressed. Thank you.

27 SENATOR HAWKINS: Thank you. As I said, this is something that will be an
28 ongoing conversation for the next few days, and I look forward to that. Any further comments?

29
30 PROCEEDINGS CONCLUDED.

31
32
33 CERTIFICATE OF THE COURT REPORTER

34
35
36 I, Medford W. Howard, Registered Professional Reporter and Notary Public for the
37 State of Virginia at large, do hereby certify that I was the court reporter who took down and transcribed
38 the proceedings of the **Full Commission Meeting when held on Tuesday, January 11, 2005 at 10:00**
39 **a.m. in Senate Room A, General Assembly Building, Richmond, Virginia.**

40 I further certify this is a true and accurate transcript to the best of my ability to hear
41 and understand the proceedings.

42 Given under my hand this 17th day of January, 2005.

Medford W. Howard
Registered Professional Reporter
Notary Public for the State of Virginia at Large

My Commission Expires: October 31, 2006.